filed 6/30/82

No 81-2394

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

-against-

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

JURISDICTIONAL STATEMENT

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June 30, 1982

QUESTIONS PRESENTED

1. Whether the grant by New York State of a large credit against the franchise tax payable by the corporate parent of a domestic international sales corporation ("DISC") *only* with respect to income attributable to shipments made from New York violates the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution?

2. Whether New York State's practice of combining the income of a DISC with that of its parent violates the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution, where New York State does not so combine the income of non-DISC subsidiaries and where the State uses that device to tax the income of other affiliates of the parent not doing business in New York.*

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* Westinghouse Electric Corporation was the respondent-appellant in the New York Court of Appeals. James H. Tully, Jr., Milton Koerner and Thomas H. Lynch, as the Tax Commission of the State of New York, were the appellants-respondents.

TABLE OF CONTENTS

	PAGE
Questions Presented	i
Table of Contents	ii
Table of Authorities	iii
Decisions of the Courts and Agency Below	1
Jurisdictional Basis of this Appeal	2
Constitutional Provisions and Statutes Involved	2
Statement of the Case	3
Statement of Facts	3
The Proceedings Below	6
The Questions Presented Are Substantial	7
I. The New York Franchise Tax Unconstitutionally Discriminates Against Persons Exporting Products From Outside New York State By Subjecting The New York Income Of Such Persons To A Greater Tax Than The Same Amount Of New York Income In The Hands Of A Person Who Exports Products From Within New York State	7
II. New York's Requirement That The Income Of Westinghouse's Non-New York DISC Subsidiary Be Combined With That Of Its Parent Is Unconstitutional	11
Conclusion	17
Appendix	
Opinion of the Court of Appeals	1a
Order of the Appellate Division	11a
Decision of the Appellate Division	13a
Order of the Supreme Court	18a
Decision of the State Tax Commission	20a
Order of the Court of Appeals	27a
Notice of Appeal	28a
Constitutional and Statutory Provisions Involved	30a
United States Constitution	30a
Internal Revenue Code of 1954, §§991-997	31a
New York Tax Law, Article 9-A	56a

TABLE OF AUTHORITIES

	PAGE
Cases	
Allied Stores of Ohio, Inc. v. *Bowers*, 358 U.S. 522 (1959)	11
Boston Stock Exchange v. *State Tax Commission*, 429 U.S. 318 (1977)	9, 10
Hines v. *Davidowitz*, 312 U.S. 52 (1941)	13
International Harvester Co. v. *Dep't of Treasury*, 322 U.S. 340 (1944)	9
International Harvester Co. v. *Evatt*, 329 U.S. 416 (1947)	9
Japan Line, Ltd. v. *County of Los Angeles*, 441 U.S. 434 (1979)	12, 15
Maryland v. *Louisiana*, 101 S. Ct. 2114 (1981)	9, 10, 14
McGoldrick v. *Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940)	9
McGoldrick v. *Gulf Oil Corp.*, 309 U.S. 414 (1940)	13, 14
Michelin Tire Corp. v. *Wages*, 423 U.S. 276 (1976)	15
Miller Bros. Co. v. *Maryland*, 347 U.S. 340 (1954)	16
Mobil Oil Corp. v. *Commissioner*, 445 U.S. 425 (1980)	16
Western Live Stock Co. v. *Bureau of Revenue*, 303 U.S. 250 (1938)	9
Wheeling Steel Corp. v. *Glander*, 337 U.S. 562 (1949)	11
Constitution and Statutes	
U.S. Const., Art. I, § 8	*passim*
U.S. Const., Art. VI	2
U.S. Const., Amend. 14, § 1	*passim*
26 U.S.C. §§ 991-997	2, 3
26 U.S.C. § 991	3, 4
26 U.S.C. § 992	4
26 U.S.C. § 995	3, 5
28 U.S.C. § 1257(2)	2
Tax Reduction Act of 1975, 89 Stat. 26	12
Tax Reform Act of 1976, 90 Stat. 1525	12
N.Y.C.P.L.R., Art. 78	6
N.Y. Tax Law, Art. 9-A	2
N.Y. Tax Law § 208.9	5, 6, 7, 11
N.Y. Tax Law § 210.3	14
N.Y. Tax Law § 210.13	4, 5, 7-11

PAGE

Other Authorities

Hearings Before the House Committee on Ways and Means on Tax Proposals Contained in the President's New Economic Policy (92d Cong., 1st Sess.) (1971) .. 14

H.R. Rep. No. 92-533 (92d Cong., 1st Sess.), *reprinted in* 1971 U.S. Code Cong. & Ad. News 1825 12

New York State Division of the Budget Report in bill jacket of L. 1972, ch. 779 8

S. Rep. No. 92-437 (92d Cong., 1st Sess.), *reprinted in* 1971 U.S. Code Cong. & Ad. News 1918 ..... 3, 12

U.S. Department of the Treasury, 1979 Annual Report: The Operation and Effect of the Domestic International Sales Corporation Legislation (April 1981) ... 11, 12

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-against-

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ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

JURISDICTIONAL STATEMENT

DECISIONS OF THE COURTS AND AGENCY BELOW

The opinion of the New York Court of Appeals, dated April 1, 1982, is reported at 55 N.Y. 2d 364 and 449 N.Y.S. 2d 677, and is reprinted in the Appendix ("App.") at pages 1a-10a. The unpublished Order of the New York Appellate Division, Third Judicial Department, dated June 29, 1981, appears at App. 11a-12a. The decision of the Appellate Division, Third Judicial Department, dated June 18, 1981, is reported at 82 A.D. 2d 988 and 440 N.Y.S. 2d 397, and is reprinted at App. 13a-17a. The unpublished order of the Supreme Court of the State of New York transferring the proceedings to the Appellate Division, dated January 25, 1980,

appears at App. 18a-19a. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at App. 20a-26a.

JURISDICTIONAL BASIS OF THIS APPEAL

This is an appeal from a final judgment of the Court of Appeals of the State of New York which upheld provisions of New York law imposing a tax on the shareholders of a DISC against the contentions that the statute violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution. The decision of the Court of Appeals of New York was entered on April 1, 1982 (App. 27a). The Notice of Appeal was filed on June 28, 1982 (App. 28a-29a). This Court has jurisdiction of the appeal by virtue of 28 U.S.C. §1257(2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, §8, Clause 3 (the Commerce Clause) of the United States Constitution appears at App. 30a.

Article VI of the United States Constitution appears at App. 30a.

Amendment 14, §1 of the United States Constitution appears at App. 30a.

Sections 991-997 of the Internal Revenue Code of 1954, as amended, the provisions governing Federal taxation of DISCs as in effect for the relevant years, appear at App. 31a-55a.

New York Tax Law, Article 9-A, sections 208.1, 208.8-A, 208.9(a), 208.9(i), 209.6, 210.1-210.3, 210.13 and 211.1, the provisions governing the State franchise tax on DISCs as in effect during the relevant years, appear at App. 56a-67a.

STATEMENT OF THE CASE

Statement of Facts

As part of the Revenue Act of 1971, Congress—with the intention to "provide tax incentives for U.S. firms to increase their exports" and thereby to "improve our balance of payments"[1]—authorized the establishment of a unique new corporate entity known as a "Domestic International Sales Corporation" or "DISC". Internal Revenue Code of 1954 ("Code"), 26 U.S.C. §§991-997 (App. 31a-55a). A corporation qualifies as a DISC if substantially all of its gross receipts and assets are export related. Under the DISC provisions of the Code in effect in 1972 and 1973, the tax years here in question, and as relevant here, the income of a DISC was not taxed to the DISC at all (Code §991). Instead, a portion of its income was taxed to the DISC's shareholders (Code §995(a)). A minimum of one-half of the DISC's income was taxed to its shareholders on a current basis whether or not it was actually distributed (this income is known as "deemed distributions") (Code §995(b)). Taxes on the remainder were deferred until the income (known as "accumulated DISC income") was actually distributed or the corporation no longer qualified as a DISC (Code §995). Effectively, then, up to one-half of a DISC's income was not taxed at all under the 1971 Act for as long as it was retained by the DISC.

In response to the Federal legislation, New York in 1972 enacted the tax statute at issue here (App. 56a-67a) as an amendment to its general corporate franchise tax. In practical effect, New York sought to impose a franchise tax based on the *total* income of a DISC, including the half of that income as to which all Federal tax was deferred. In addition, with the specific purpose of encouraging export sales to be made through facilities in New York State, the New York law granted a substantial credit against the tax otherwise due with

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[1] S. Rep. No. 92-437 (92d Cong., 1st Sess.), *reprinted in* 1971 U. S. Code Cong. & Ad. News 1918, 1928.

respect to accumulated DISC income, but only to the extent that the DISC had income derived from products "shipped from a regular place of business of the taxpayer within [New York] state".[2] No credit was allowed for merchandise exported from locations in the United States outside of New York.

As stipulated by the parties below (App. 21a-26a), appellant Westinghouse Electric Corporation ("Westinghouse") is a Pennsylvania corporation engaged in the manufacture and sale of such products as electrical equipment, parts and appliances. Westinghouse is qualified to and does business in New York State, regularly paying corporate income and franchise taxes there. Westinghouse has a number of U.S. affiliates, however, which—as stipulated by respondents—do not do any business in New York ("non-New York affiliates").

Westinghouse owns all of the stock of Westinghouse Electric Export Corporation ("Westinghouse Export" or "Export"), which qualified as a DISC under §992(a) of the Code in 1972 and 1973. Westinghouse Export acted as a commission agent on behalf of both Westinghouse and its non-New York affiliates for export sales of products and related services manufactured in the United States during 1972 and 1973, and, as stipulated, all of its income consisted of commissions on such sales. Under Code §991, Westinghouse Export was exempt from Federal income tax for those years. In 1972 and 1973, Westinghouse Export had no employees in New York, did not engage in any business activities or maintain an office in New York, employed no capital in New York, did not own or lease real or tangible personal property in New York, paid no real estate rentals in New York, and did not file a New York corporate franchise tax return.

Westinghouse Export's total income in 1972 was just under $26 million; of this amount, about one-quarter was received from Westinghouse-affiliated companies not doing business in New York and the remainder was received from Westinghouse

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[2] N. Y. Tax Law §210.13(a). The credit effectively reduced the tax rate on such income by 70 percent.

itself.[3] On its 1972 Federal income tax return, pursuant to Code §995(b), and on its 1972 New York State franchise tax return, Westinghouse included as income, and paid taxes upon, one-half of Export's total income (or just under $13 million). Similarly, in 1973, the income of Westinghouse Export was nearly $58 million, of which almost one-fifth was received from non-New York affiliates and the remainder from Westinghouse; $29.8 million of Export's income was deemed distributed to Westinghouse under Code §995(b), was subject to Federal income tax and was reported on Westinghouse's New York State franchise tax return.[4] In both 1972 and 1973, Westinghouse incurred no Federal income tax liability for the approximately one-half of Export's income—its accumulated DISC income—that was not distributed.

This case arose when the New York State Tax Commission (whose members are appellees here) sought to include in Westinghouse's "entire net income" subject to the State franchise tax for 1972 and 1973 not only the amounts subject to Federal tax, but also the accumulated DISC income not subject to current Federal taxation. The State Tax Commission computed Westinghouse's franchise tax by combining all of Westinghouse Export's receipts, expenses, assets and liabilities with those of Westinghouse pursuant to N.Y. Tax Law §208.9(i)(B). The Commission then afforded Westinghouse a credit pursuant to N.Y. Tax Law §210.13(a), but only to the extent that the accumulated DISC income of Westinghouse Export was attributable to shipments made from a regular place of business in New York. Only about 5% of Export's receipts came from such New York shipments. As a result, the

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[3] Total Westinghouse Export income for 1972 was $25,987,000, of which $19,888,000 was received from Westinghouse and $6,099,000 from non-New York affiliates.

[4] More precisely, Export's 1973 income was $57,948,738, of which $47,180,132 was received from Westinghouse and $10,768,606 from non-New York affiliates. Deemed distributions from Westinghouse to Export were $29,838,006, on which the latter paid Federal income and State franchise taxes.

Commission alleged deficiencies in Westinghouse's franchise tax payments of $71,970 for 1972 and $151,436.76 for 1973. (App. 22a-25a.)

The Proceedings Below

In response to the State Tax Commission's notices of deficiency for 1972 and 1973, Westinghouse filed a petition, and later a perfected petition, for redetermination. The perfected petition alleged that, by requiring Westinghouse to compute its franchise tax liability by combining its receipts and expenses with those of Westinghouse Export, thereby taxing both Export's accumulated DISC income and its deemed distributions, appellees violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. Westinghouse also contended that limiting the export credit to income attributable to shipments from New York violated the Commerce Clause and the Equal Protection Clause. The State Tax Commission rejected Westinghouse's contentions, concluding that "the constitutionality of the laws of the State of New York is presumed at the administrative level" (App. 26a).

Westinghouse reiterated all of its constitutional claims against the franchise tax in a petition to the New York Supreme Court under Article 78, N.Y.C.P.L.R., for review of the findings of the State Tax Commission. The Supreme Court transferred the proceeding to the Appellate Division, Third Judicial Department, for disposition (App. 18a-19a).

The Appellate Division, two justices dissenting, struck down a portion of the franchise tax. It held that N.Y. Tax Law §208.9(i)(B) was unconstitutional because it required Westinghouse Export's accumulated DISC income to be included in calculating Westinghouse's "entire net income" for franchise tax purposes. The Appellate Division did not reach Westinghouse's due process claim concerning accumulated income, nor did it decide the constitutionality of the tax credit. It did reject Westinghouse's due process and equal protection claims

against the taxation of deemed distribution income. (App. 13a-17a.)

The State Tax Commission appealed from that portion of the Appellate Division's decision that invalidated Section 208.9(i)(B), and Westinghouse cross-appealed to the extent that the Appellate Division had upheld the tax on deemed distributions. Westinghouse again raised the constitutional arguments that it had presented before the State Tax Commission and the Appellate Division, and which it now brings before this Court. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects. (App. 1a-10a.) Its judgment reversed the Appellate Division in part and reinstated the determination of the State Tax Commission. (App. 10a, 27a.)

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

I. THE NEW YORK FRANCHISE TAX UNCONSTITUTIONALLY DISCRIMINATES AGAINST PERSONS EXPORTING PRODUCTS FROM OUTSIDE NEW YORK STATE BY SUBJECTING THE NEW YORK INCOME OF SUCH PERSONS TO A GREATER TAX THAN THE SAME AMOUNT OF NEW YORK INCOME IN THE HANDS OF A PERSON WHO EXPORTS PRODUCTS FROM WITHIN NEW YORK STATE.

Section 210.13(a) of the New York Tax Law provides a credit against the franchise tax otherwise payable by a corporation on account of accumulated DISC income retained by a DISC subsidiary. That credit is, however, granted in a constitutionally impermissible fashion: It applies only to that portion of a DISC's accumulated income that is attributable to export sales "shipped from a regular place of business of the taxpayer within [New York] state."[5] No credit is given for

[5] Technically, the credit was computed for Westinghouse by first calculating the ratio of Westinghouse's receipts from export sales on which Westinghouse Export received commissions that were "shipped

sales of products shipped overseas from a place of business outside of New York State. The credit is equal to 70% of the tax otherwise payable on account of the accumulated DISC income.

The avowed purpose of the credit was to pressure firms engaged in the export trade to locate their operations in New York State.[6] As the Court of Appeals noted:

> "The credit was devised . . . to provide shareholders of DISCs with State tax incentives akin to those that had been enacted by the Federal Government. Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners. While Congress chose to provide the benefit in the form of a tax deferral, our State Legislature elected to use a tax credit." (App. 7a-8a; citations omitted.)

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from a regular place of business of the taxpayer in [New York] state" to the total receipts on the sale of export property on which Export received commissions. That ratio was 4.7% for 1972 and 5.5% for 1973. The ratio was then multiplied by Westinghouse Export's accumulated DISC income for each of those years, with the products representing the sums eligible for the credit. The respective products were then multiplied by Westinghouse's business allocation percentage as calculated under New York's usual allocation formula (which is not itself challenged here except for the manner of its application to DISC income). This product represents that portion of the accumulated DISC income allegedly subject to New York tax and attributable to New York shipments. The credit is equal to 70% of that amount times the tax rate, which was 9% in 1972 and 1973. (See App. 23a-25a.)

[6] For example, the report of the State Division of the Budget supporting enactment of the credit noted that the credit would be "a means of providing a positive incentive for increased export business activity in New York State" and would "result in an indeterminable but perhaps significant improvement in the State's economy"; the report rejected the notion of "full taxation of DISCs" because that "would undoubtedly encourage their formation outside the State". New York State Division of the Budget Report in bill jacket [at pp. 6, 8] of L. 1972, ch. 779.

What the Court of Appeals failed to recognize is that—while it is perfectly proper for the Federal government to encourage American firms to export products from this country for the purpose, for example, of increasing employment and improving our international balance of payments—it is unconstitutional under our Federal system for a state to encourage businesses to locate within its borders by means of a tax that discriminates against business operations conducted in other states. *E.g., Maryland v. Louisiana*, 101 S. Ct. 2114 (1981); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977); *cf. International Harvester Co. v. Evatt*, 329 U.S. 416 (1947); *International Harvester Co. v. Dep't of Treasury*, 322 U.S. 340 (1944); *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940); *Western Live Stock Co. v. Bureau of Revenue*, 303 U.S. 250 (1938).

The formula employed by New York in section 210.13(a) to calculate the franchise tax credit has the effect of taxing the same amount of income allocated to New York by two different taxpayers at different rates depending on the state from which the taxpayer chooses to ship its products. For example, assuming a tax rate of 10%, a corporation with accumulated DISC income of $1000, half of which is allocable to New York, will pay $50 in tax if it ships its goods from New Jersey. But a firm with the same accumulated DISC income, of which the same one-half is allocable to New York—but shipping its goods from New York—will pay only $15 in tax. Thus, New York substantially penalizes a taxpayer for shipping from New Jersey. This is precisely the kind of discrimination that is forbidden by the Commerce Clause.

This Court has repeatedly struck down similar discriminatory attempts by states to provide tax advantages to business activity within their borders at the expense of other states. For example, in *Boston Stock Exchange v. State Tax Commission*, this Court struck down under the Commerce Clause an amendment to the New York stock transfer tax by which (a) the tax payable by nonresidents was cut in half when the transaction involved an in-state sale but not when it

involved an out-of-state sale; and (b) a maximum tax of $350 was applied to a single transaction (by either a resident or a nonresident) when the sale took place in-state but not when it took place elsewhere. This Court held both provisions unconstitutional because "[n]o State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business' ". 429 U.S. at 329 (citations omitted). Like the transfer tax in *Boston Stock Exchange*, the franchise tax in this case "imposes a greater tax liability on out-of-state sales than on in-state sales," and therefore "falls short of the substantially even-handed treatment demanded by the Commerce Clause". *Id.* at 332.

In *Maryland v. Louisiana*, this Court applied the same principles to strike down Louisiana's severance tax on natural gas, under which in-state users of gas paid a lower tax through exemptions and credits than out-of-state purchasers. 101 S. Ct. at 2132-36. Significantly, the Court noted that the basic purpose of the Commerce Clause was "to prohibit the multiplication of preferential trade areas", *id.* at 2133, which is precisely the vice from which New York's franchise tax credit suffers. Under *Boston Stock Exchange* and *Maryland v. Louisiana*, the New York tax must be struck down.

The Court of Appeals erred when it upheld New York's discriminatory tax credit on the ground that the State is merely forgiving a portion of a tax which it is otherwise constitutionally entitled to impose. While that premise is faulty, as is shown below, even assuming it to be correct, the argument proves too much. It could be used to justify any discriminatory tax so long as the legislature first levied a proper tax and then forgave all or a portion of it to the favored few. But the class whose tax is forgiven also must be chosen in a constitutionally legitimate manner. New York would never contend that, since it may constitutionally impose an equal sales tax on all transactions within the State, it could also forgive 70% of that tax when a sale was made by a merchant belonging to a particular racial or religious group. Similarly, the Commerce Clause guarantees

substantially equal treatment to an export business whether it is conducted inside or outside New York.

In addition, the franchise tax violates the Equal Protection Clause. By imposing a different effective tax rate depending upon the locus of export sales activity, it fails to treat export businesses operating across state lines in the same manner as such businesses operating entirely within New York. But once a state allows foreign corporations to do business within its borders, "the adopted corporations are entitled to equal protection with the state's own corporate progeny". *Wheeling Steel Corp. v. Glander,* 337 U.S. 562, 571 (1949) (striking down state law that taxed intangibles of foreign but not domestic corporations). *See also Allied Stores of Ohio, Inc. v. Bowers,* 358 U.S. 522, 527 (1959).[7]

II. NEW YORK'S REQUIREMENT THAT THE INCOME OF WESTINGHOUSE'S NON-NEW YORK DISC SUBSIDIARY BE COMBINED WITH THAT OF ITS PARENT IS UNCONSTITUTIONAL.

The question of the proper boundaries of the states' powers to tax DISCs is one of national importance. As of tax year 1979, according to Treasury Department statistics, there were some 7,200 DISCs with total gross receipts of almost $100 billion, net income of $6.4 billion and tax deferred income of over $2 billion.[8] The Treasury estimated that the existence of

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[7] Moreover, the discriminatory purpose of the credit to pressure export shippers to locate in New York is furthered by the fact that the franchise tax (apart from the credit) impermissibly distinguishes between dividends paid to a parent corporation by DISC subsidiaries (all of which are taxed to the parent) and dividends paid by all other corporate subsidiaries (which in general are not subject to the franchise tax, N. Y. Tax Law §208.9(a)(1)). The result is that in the case of non-DISC subsidiaries, none of the income of the subsidiary is taxed to the parent, even if all of it is actually distributed to the parent. In the case of a DISC, all of the income is taxed to the parent, even if none is in fact distributed.

[8] U.S. Department of the Treasury, 1979 Annual Report: The Operation and Effect of the Domestic International Sales Corporation Legislation (April 1981) ("DISC Report") at 28 (Table 5-2). The

the DISC legislation resulted in an increase in United States exports in 1979 of between $4.5 billion and $7 billion.[9]

Yet by singling out DISCs for special, disparate tax treatment, New York undermines this important national policy. It creates an impermissible conflict between state and national policy in the area of foreign trade—an area in which it is vital that the nation speak "with one voice". *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 449 (1979). As the Appellate Division correctly held in this case:

> "The DISC provisions of the Code being unmistakably aimed at improving foreign commerce, any state impediment hindering that congressional intent is not constitutionally allowable." (App. 15a.)

Congress carefully designed the DISC provisions of the Code not only "to provide tax incentives for U.S. firms to increase their exports . . . but also to remove a present disadvantage of U.S. companies engaged in export activities through domestic corporations".[10] Prior to enactment of the DISC provisions, such firms were "treated less favorably than [American] firms which manufacture abroad through the use of foreign subsidiary corporations".[11] In the former case, the United States corporation was fully and immediately taxable on its entire income from export sales. In the latter case, foreign tax might be minimal and United States tax was imposed only when (and if) income was remitted to the United States parent as a dividend. Congress' solution was to exempt the DISC from tax, to tax a portion (approximately 50%) of the DISC's income currently to its shareholders and to defer tax on the

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DISC statute was amended in some respects by the Tax Reduction Act of 1975, 89 Stat 26, and the Tax Reform Act of 1976, 90 Stat. 1525.

[9] DISC Report at 2.

[10] H. R. Rep. No. 92-533 (92d Cong., 1st Sess.), *reprinted in* 1971 U. S. Code Cong. & Ad. News 1825, 1872. *See also* S. Rep. No. 92-437, *supra*, 1971 U.S. Code Cong. & Ad. News at 1996.

[11] *See* note 10 *supra*.

remaining accumulated DISC income. Congress thus intended to encourage domestic production of goods for export by eliminating the tax advantages created by overseas production.

The New York franchise tax, however, is irremediably inconsistent with the Federal tax structure. New York has attempted to tax the accumulated DISC income which Congress decided to leave untaxed. Such a tax cannot help but stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" and therefore is invalid. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). As the Appellate Division held, this aspect of the franchise tax unconstitutionally "diminish[es] the tax advantages Congress bestowed on United States corporations engaged in foreign trade" (App. 15a).

This Court's decision in *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), invalidating a New York City tax, is particularly instructive in this respect. In that case, the City sought to impose a sales tax upon oil sold locally to ships engaged in foreign commerce. The oil was exempt from Federal excise taxes under the Revenue Act of 1932, but that statute contained no express exemption from state taxes. This Court found that the exemption from Federal taxation expressed a Congressional intent "to enable American refiners to meet foreign competition and to recover trade which had been lost", *id.* at 427. The Court concluded:

> "It is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duty." *Id.* at 429.

Thus, even absent specific preemptive language, this Court looked to the broad purposes of Congress' use of the taxing power to encourage foreign commerce. The same principles apply here and the court below should have reached the same

result.[12] If anything, this case is stronger for the taxpayer than *McGoldrick*, since that case involved a sales tax of general applicability, while in the present case, New York has singled out DISCs for special taxation.

New York's practice of singling out DISC subsidiaries for special treatment further flaws its tax scheme. The franchise tax, as it applies to both deemed distributions and accumulated DISC income, "'in its practical operation work[s] discrimination against interstate commerce.'" *Maryland v. Louisiana*, 101 S. Ct. at 2134 (citations omitted). It does so by requiring that all of a DISC's income be combined with that of the parent corporation and then applying the State's business allocation percentage to the combined entity. This contrasts with New York's uniform practice for all non-DISC corporate subsidiaries under which income and business allocation percentages are computed separately for the subsidiary and the parent. In this case, where the business allocation percentage of Westinghouse Export taken alone would be zero,[13] the effect of automatically combining the income of Westinghouse and Export is impermissibly to increase the share of Export's income that is subject to taxation by New York. Since all of Export's

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[12] The *McGoldrick* decision did not turn, as the Court of Appeals suggested (App. 6a), on the technical conditions that Congress imposed on the handling of the oil to qualify for the tax exemption. In any event, Congress imposed analogous conditions on corporations seeking treatment as DISCs, conditions indisputably met in this case.

Nor does the brief comment in the legislative history relied on by the Court of Appeals (App. 5a-6a) support its conclusion that Congress intended to permit state taxation of DISCs which would undermine the Federal law. At most, the comment indicates that states may tax DISCs only to the same extent as the Federal government taxes them by "piggybacking on the Federal corporate income tax". *See* Hearings Before the House Committee on Ways and Means on Tax Proposals Contained in the President's New Economic Policy (92d Cong., 1st Sess.), Part 1 at 171 (1971).

[13] It is stipulated that Export had no employees or property in New York, and by definition it had no receipts from sales in New York because it delivered all of the products that it sold abroad. *See* N. Y. Tax Law §210.3.

income is derived from foreign commerce, the effect of the tax is to single out income from such trade for greater taxation than subsidiary income from other sources, in violation of the Commerce Clause and the Equal Protection Clause. By collapsing the income of a DISC subsidiary which does no business in the State with that of its parent, New York is attempting to impose franchise taxes on export income having no connection with the State, and it is pressuring taxpayers to shift the activities giving rise to that income into the State of New York by means of the credit described in Point I above.

Because the Federal tax rules for DISCs represent a specific Congressional regulation of foreign commerce, they are—even as compared with regulation of domestic interstate commerce—entitled to special protection from state interference. " '[T]he Government must speak with one voice when regulating commercial relations with foreign governments.' " *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. at 449, quoting *Michelin Tire Corp v. Wages*, 423 U.S. 276, 285 (1976). The New York tax creates a conflict between state and Federal policies which prevents the United States from "speaking with one voice" and disrupts our foreign commerce. It is, therefore, invalid under the Commerce Clause.

Finally, New York's action in disregarding the corporate existence of Westinghouse Export, and subjecting its income to tax irrespective of its contacts with New York, is a violation of the Due Process Clause. Westinghouse Export has no employees, property or sales in New York. Approximately 20-25% of Westinghouse Export's income is derived from export sales on behalf of Westinghouse affiliates which do not do business in New York. Appellees have never claimed that those non-New York affiliates are part of a unitary business with Westinghouse or are otherwise taxable in New York. Yet the Court of Appeals held that Export, through its Westinghouse parent, is taxable on income derived from export sales on behalf of such non-New York affiliates, irrespective of whether they are part of a unitary business with Westinghouse. That holding is plainly wrong.

"[D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). The Court of Appeals' reliance (App. 6a-7a) on the "unitary business" concept, *see, e.g., Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980), is misplaced. Neither in *Mobil* nor in any other case has this Court sustained the taxation of one corporate entity (Westinghouse) on income earned and retained by another entity (Westinghouse Export) derived from dealings with other entities (Westinghouse's non-New York affiliates) not subject to the jurisdiction of the taxing state.

Respondents' attempt to tax the income of Westinghouse Export thus represents an attempt to impose taxes on income having no nexus with activities in New York in an amount which bears no reasonable relation to the intrastate values involved. Accordingly, it violates the Due Process Clause of the Fourteenth Amendment.

CONCLUSION

For the foregoing reasons, probable jurisdiction should be noted and the case set for argument.

June 30, 1982

Respectfully submitted,

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APPENDIX

DECISION OF THE COURT OF APPEALS

STATE OF NEW YORK COURT OF APPEALS

No. 97

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,

Respondent-Appellant,

v.

JAMES H. TULLY, JR., et al., constituting the Tax Commission of the State of New York,

Appellants-Respondents.

Argued February 9, 1982; decided April 1, 1982

Robert Abrams, Attorney-General (Francis V. Dow and Shirley Adelson Siegel of counsel) for appellant.

Henry W. deKosmian and Simon Friedman, for respondent.

OPINION OF THE COURT

FUCHSBERG, J.:

In an article 78 proceeding to review a determination of the State Tax Commission which sustained corporate franchise taxes imposed pursuant to Article 9-A of the Tax Law, we are called upon to pass on the constitutionality of New York statutes which tax income emanating from the earnings of a "domestic international sales corporation" (hereinafter referred to by the acronym "DISC"), a class of corporations newly made eligible for preferential tax treatment by the Federal Revenue Act of 1971.

The primary requirement for qualification as a DISC is that a corporation must derive at least 95 per cent of its income from export sales and related services. The tax advantages it receives are intended to encourage the export of goods manufactured in the United States by compensating for the far lower taxes many foreign subsidiaries of American companies pay to the nations in which they operate (*see* H. Rep. No. 92-533, 92d Cong., lst Sess., [1971], reprinted in US Code Cong. & Admin. News 1825, 1872; S. Rep. No. 92-437, 92d Cong., lst Sess., [1971], reprinted in US Code Cong. & Admin. News 1918, 1928, 1996). To effect the contemplated tax benefit, the implementing statute, besides exempting a DISC from Federal taxation, permits half of its income to be "accumulated" without subjecting its shareholders to current Federal taxes. On the other hand, the other half is "deemed distributed" to the shareholders even if it in fact is not paid out as a dividend (*see* US Code, tit 26, § 991 *et seq.*).[1]

The DISC involved in the present proceeding, a Delaware corporation named Westinghouse Electric Export Corporation, is a wholly-owned subsidiary of Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation which does business in New York. It is undisputed that all of the DISC's business income for 1972 and 1973, the years under review here, was earned as commission agent for either Westinghouse or the latter's affiliates.[2] Moreover, it is agreed that none of the usual incidents of a nexus with New York applied to the DISC, it having operated no office, engaged no employees, conducted no business activities, employed no capital and neither owned nor leased real or tangible personal property. Concordantly, it did not file New York franchise tax returns.

It was against this background that, when Westinghouse filed its 1972 and 1973 New York franchise tax returns, though it

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[1] Since no questions are raised as to the tax ramifications of an actual distribution of DISC income or the eventual taxability of the accumulated DISC income, we do not treat with such issues in this opinion.

[2] None of the affiliates did business in New York.

included its "deemed distributions" from the DISC in its "entire net income" (*see* Tax Law, § 208.9[a][1]), it did not charge itself with any portion of the "accumulated" DISC income. Finding these returns deficient, New York State's Department of Taxation and Finance took the position that Westinghouse, in its treatment of the DISC income, had failed to comply with Tax Law, § 208.9(i)(B), which, in essence, requires a reporting corporation to compute its "entire net income" by consolidating its DISC's receipts, expenses, assets and liabilities with its own, save for transactions between it and its DISC. Such consolidation, of course, would have added the accumulated DISC income which had been deferred for Federal tax purposes.[3] Against the deficiency assessed on this basis, the Department did allow Wesinghouse a DISC export credit for merchandise "shipped from a regular place of business of the taxpayer within this state", all pursuant to a formula set out in section 210.13(a) of the Tax Law (*see infra* p. 7).

In its petition for a redetermination, Westinghouse alleged that inclusion of accumulated DISC income in its "entire net income" would impose an undue burden on interstate and foreign commerce (US Const, art I, § 8, cl 3);[4] that, in violation

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[3] Tax Law § 208.9(i)(B), in pertinent part, reads: "[A]ny taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC . . . shall . . . adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities . . . provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department".

[4] The commerce clause provides that "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

of the due process clauses of the State and Federal Constitutions, New York lacked a jurisdictional nexus upon which to tax the DISC's income; and that, if the DISC's accumulated income had to be included in "entire net income", Tax Law, § 210.13(a), which provides the tax credit, offends the commerce clause because it discriminates against shipments of export property from locations outside the State. In addition, Westinghouse, asserting that State taxation of the deemed distributions of DISC trespassed on due process and equal protection, demanded that the taxes it had paid on such be refunded.[5] The State Tax Commission rejected all of these contentions.

For its part in this proceeding, the Appellate Division, two justices dissenting, found that section 208.9(i)(B), in requiring the DISC's accumulated income to be added to the taxpayer's "entire net income", constituted an unconstitutional imposition on foreign commerce. Having found that 208.9(i)(B) violated the commerce clause, the court did not address Westinghouse's claim that the provision was also invalid for lack of due process. Nor did the court decide the constitutionality of the tax credit of 210.13[a], apparently because this section expressly is made dependent on the validity of 208.9(i)(B). Finally, it rejected Westinghouse's due process and equal protection contentions regarding the inclusion of the deemed distribution income. For the reasons which follow, we believe none of the constitutional objections has merit.

Turning at once to Westinghouse's primary argument —that the addition of the accumulated DISC income to Westinghouse's "entire net income" as called for by Tax Law § 208.9(i)(B) frustrates the efficacy of the Federal tax incentive and, therefore, runs counter to the fundamental policy dictates of the commerce clause—we first pay heed to the well-settled proposition that the ultimate power to regulate both

[5] Westinghouse also contended that the State Tax Commission had transposed certain numbers creating an arithmetical miscalculation of the tax. In its answer, the Commission conceded this error.

foreign and interstate commerce lies with Congress (*see, e.g., Gibbons v. Ogden*, 9 Wheat [22 US] 1,86-87). However, that a State chooses to act in the same field as does Congress does not automatically portend judicial nullification of the State law (*see Walhalla Associates, Inc. v. National Commercial Bank and Trust Co.*, 54 N.Y.2d 857; *see, generally*, Tribe, American Constitutional Law, § 6-24, p. 379). It all hinges on whether Congress intended to preempt State regulation (*see Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 229-230).

This said, we note that in the present case there is no explicit statement of preemption. Nor does the statutory scheme imply any such design. True, it bespeaks a plan to give special tax treatment to DISCs and their stockholders in order to encourage export sales of goods manufactured in the United States. But that some benefits were extended to accomplish this end does not mean that every possible kind was intended. To the contrary, even as to Federal taxation, the incentives tendered a DISC's shareholders, the ultimate beneficiaries of a DISC's tax preferment, are far more limited than those offered to the DISC per se.[6]

Most persuasive is the relevant legislative history. This leaves little to implication. On September 8, 1971, shortly before the DISC legislation was enacted, John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, spokesman for the sponsoring department, in the company of then Secretary of Treasury John B. Connally, officially appeared at a hearing before the Committee on Ways and Means of the House of Representatives. There, Mr. Nolan, in response to an expression of committee concern that the proposal might "prohibit States from levying corporate income taxes on a DISC" was unequivocal in his declaration that the proposed bill would leave the States "free to impose the tax, if they choose to do so" (*see* Hearings before House Committee on Ways and

[6] We also observe that even accumulated DISC income is taxable to the shareholders when it is distributed, when a shareholder sells his stock or when the corporation no longer qualifies as a DISC (*see* US Code, tit 26, § 995).

Means on the Tax Proposals Contained in the President's New Economic Policy, 92nd Cong., 1st Sess., Part I, pp. 170-171). Moreover, not without significance, proposed legislation which might have preempted the States from taxing DISCs was considered by the same committee in 1980, only to be permitted to die without any action (*see* HR 5076, 96th Cong., 2nd Sess.; Hearing before Committee on Ways and Means on State Taxation of Foreign Source Income, p. 29, 326). Overall, then, our State is far from constrained by a clear statement that Congress intended to exercise its commerce power in full (*see* Tribe, American Constitutional Law, § 5-8, p. 243).

On this point, comments also are in order on *McGoldrick v. Gulf Oil Corp.* (309 U.S. 414) to which Westinghouse adverts to support its position. There, a Federal statute permitted the importation of crude petroleum into the United States free of import duty. However, the statute specified that the petroleum be imported, converted into fuel oil and then sold solely for fuel in propelling foreign-bound vessels in foreign commerce, all while in bond. These *congressionally-designed* conditions prevented the segregated oil from ever becoming a part of "the common mass of property in the state" (*McGoldrick, supra,* at p. 423). The Supreme Court emphasized that it was this integrated structure for assuring that the oil never left the stream of foreign commerce, which has no parallel in this case, that compelled the conclusion that "while in bonded warehouse, [the oil is] free from state taxation" (*McGoldrick, supra,* at pp. 428-429).

The second prong of Westinghouse's constitutional attack on section 208.9(i)(B) is that, since neither the DISC nor any of Westinghouse's affiliates for which it acted as export commission agent were engaged in business in New York, the State lacked the jurisdictional nexus to satisfy the minimal due process standards on which the right to tax must be predicated. We find this assertion equally without merit. Revealing in this connection is the recent decision in *Mobil Oil Corporation v. Commissioner of Taxes* (445 U.S. 425). In the context of a challenge to Vermont's taxation of dividend income received by

a taxpayer from foreign subsidiaries and affiliates, the court reminded us that in such a case, due process mandates can be met by a State's apportionment formula so long as it is reasonably designed to reflect the percentage of a unitary business' profits connected with the State (*see Mobil Oil, supra,* at pp. 436-440; *cf. American Ins. Assn. v. Lewis,* 50 N.Y.2d 617, 623-624).

Here the record shows that Westinghouse and its DISC were operating a unitary business. Not all the accumulated DISC income was subjected to taxation, but rather only that part allocable to New York (Tax Law, §§ 208.9[i][B], 210.1[a], 210.3; *cf. Fischbach & Moore v. Tax Comm.,* 36 N.Y.2d 605, 607). Moreover, there is nothing in the record to show that the income was improperly apportioned to business done in New York; nor does the taxpayer question our State's allocation formula.[7]

This brings us to the Westinghouse argument that, even if the inclusion of the accumulated DISC income required by section 208.9(i)(B), standing alone, does not contravene the commerce clause, an infringement occurs when it is acted upon by the tax credit provided for in section 210.13(a). It reasons that the effect of the credit is impermissibly to subject its export sales from a non-New York "place of business" to a higher rate of tax than comparable sales "shipped from a regular place of business" within New York.

The credit was devised, by the State on its own, to provide shareholders of DISCs with State tax incentives akin to those which had been enacted by the Federal government (*see* Letter from Norman F. Gallman, Commissioner of Taxation and Finance to Governor Nelson A. Rockefeller in bill jacket [at p.

[7] Tax Law § 210.3 provides for an allocation of a taxpayer's total business income from all sources by the application of a three-factor formula, the three factors being the fractions represented by a taxpayer's property within New York over all its property, a taxpayer's payroll within New York over its total payroll and a taxpayer's receipts from within New York over its total receipts.

3-4] of L 1972, ch 778; Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778; Division of the Budget Report in bill jacket [at p. 19] of L 1972, ch 778). Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners (*see* Letter from Arthur M. Arnold, Director of Taxation and Governmental Affairs of the Empire State Chamber of Commerce in bill jacket [at p. 28] of L 1972, ch 778; Memorandum in Support by New York Chamber of Commerce in bill jacket [at p. 29] of L 1972, ch 778). While Congress chose to provide the benefit in the form of a tax deferral, our State Legislature elected to use a tax credit.

That a State's tax structure is so used hardly requires an *ipso facto* finding that we have discriminated against multi-state enterprises in favor of intrastate corporations. Rather, States are free to use their taxing power "to encourage the growth and development of intrastate commerce and industry . . . [and to] compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy" (*Boston Stock Exchange v. State Tax Commn.*, 429 U.S. 318, 336-337). That this is what the credit allowed by § 210.13(a) accomplishes, and no more, is demonstrated by a review of how it is calculated.

The first step to be taken to arrive at the amount of such tax credit is to multiply the taxpayer's share of the accumulated DISC income by the taxpayer's New York "business allocation percentage" (Tax Law, § 210.3). This yields the dollar value of the accumulated DISC income allocable to New York as *in-state* earnings. This amount is then multiplied by that percentage which the taxpayer's receipts from export property on which the DISC earned commissions *and* which was shipped from a regular place of business in New York bears to the taxpayer's total receipts from the sale of export property on which the DISC earned commissions. The product of this calculation is the amount eligible for the credit; it is merely a

subdivision of the accumulated DISC income allocable to New York.[8]

Obviously, the business allocation percentage plays an integral role in computing the tax credit. It determines what amount of the taxpayer's income has a jurisdictional nexus with the State. The result is that, when the State exercises its taxing power, it does so consistently with due process mandates (*Northwestern Cement Co. v. Minnesota*, 358 U.S. 450; *Wisconsin v. Penney Co.*, 311 U.S. 435).

But New York need not tax all which it has the right to tax. The credit here simply forgives a portion of that income which New York may tax by reference to shipments of export property from a regular place of business in New York, an additional New York relationship. Such a method clearly satisfies due process, and any effect on interstate commerce is too indirect to run afoul of the commerce clause.

Now, having disposed of the arguments on which Westinghouse seeks to overturn the Tax Commission's assessment, we treat with its claim for reimbursement of its allegedly mistaken payment of tax on the deemed distributions. Its position, again cast in constitutional terms, is that taxation of such income infringes upon both due process and equal protection.

Its alleged due process position is no different from the one it took regarding taxation of accumulated DISC income, *i.e.*, New York lacks a sufficient nexus with the DISC to tax its income. But, since Westinghouse and the DISC are parts of a unitary business and there is an apportionment of the income

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[8] The dollar value of the credit is then determined by multiplying the amount available for the credit by 70% and then by the tax rate (Tax Law, § 210.13[a]). According to a memorandum prepared by the State Department of Commerce before the DISC legislation was enacted, "[t]he 70 percent factor included in the export credit formula [was] apparently designed to minimize revenue loss while still providing some tax incentive for the export business" (Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778).

allocable to New York, there is no due process violation (*Mobil Oil Corporation v. Tax Commissioner*, 445 U.S. 425, *supra*).

As for equal protection, Westinghouse would have us hold that, since New York law provides that the income from all non-DISC subsidiaries is exempt from the State's franchise tax (Tax Law, § 208.9[a][1]), it is irrational to tax it on the deemed distribution income of its wholly-owned DISC subsidiary (Tax Law, § 208.8-A[b]). But, if the DISC had not elected to be treated as a domestic international sales corporation, the intercompany transactions in which it engaged would have compelled the Commission to require it and Westinghouse to file a combined report (see Tax Law, § 211 [4]). In the event, the allocated income of the DISC would be combined with the allocated income of Westinghouse (*see Matter of Wurlitzer Co. v. State Tax Commn.*, 35 N.Y.2d 100). As the Appellate Division correctly observed, "[t]here is nothing in the record to indicate that petitioner's tax liability resulting from a combined report . . . would be less than that which was in fact imposed" (82 A.D.2d 988, 989).

For all these reasons, the judgment of the Appellate Division should be modified by reinstating the determination of the State Tax Commission.

Chief Judge COOKE and Judges JASEN, GABRIELLI, JONES, WACHTLER and MEYER concur.

Judgment modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed.

ORDER OF THE APPELLATE DIVISION

At a Term of the Appellate Division of the Supreme Court of the State of New York, held in and for the Third Judicial Department in the City of Albany, New York, commencing on the 20th day of April 1981.

PRESENT:

Hon. A. FRANKLIN MAHONEY,
Presiding Justice,

Hon. ROBERT G. MAIN,
Hon. ANN T. MIKOLL,
Hon. PAUL J. YESAWICH, JR.,
Hon. J. CLARENCE HERLIHY,
Associate Justices.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

v.

JAMES H. TULLY JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

Albany County Clerk's Index No. 11313/79

Order of Annullment

The above-named petitioner, having instituted this proceeding in the Supreme Court, Albany County, pursuant to Article 78 of the Civil Practice Law and Rules, to review a determination of respondents, dated August 31, 1979, which sustained the imposition of corporate franchise tax assessments

imposed pursuant to Article 9-A of the Tax Law and said proceeding having been transferred for disposition to the Appellate Division, Third Department, by order of the Supreme Court, Albany County, dated and entered on January 25, 1980, and having been presented during the above-stated Term of this Court, and having been argued by Cravath, Swaine & Moore (Henry W. de Kosmian, of counsel), for petitioner, and by Robert Abrams, Attorney General of the State of New York (Francis V. Dow, Assistant Attorney General, of counsel), for respondents, and after due deliberation the Court having rendered a decision on the 18th day of June, 1981, Mahoney, Presiding Justice and Herlihy, Justice, dissenting, it is hereby

ORDERED, that the determination be and the same hereby is annulled, with costs, and the matter is remitted to the respondent Tax Commission of the State of New York for further proceedings not inconsistent with the June 18, 1981, decision of this Court.

ENTER:

JOHN J. O'BRIEN
Clerk

DATED AND ENTERED: June 29, 1981.

A TRUE COPY
/s/ JOHN J. O'BRIEN
Clerk

DECISION OF THE APPELLATE DIVISION, SUPREME COURT OF THE STATE OF NEW YORK, THIRD JUDICIAL DEPARTMENT

June 18, 1981 No. 39582

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

v.

JAMES H. TULLY, JR., et al., Constituting the Tax Commission of the State of New York,
Respondents.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court at Special Term, entered in Albany County) to review a determination of the State Tax Commission, which sustained corporate franchise tax assessments imposed pursuant to article 9-A of the Tax Law.

The principal issue presented is whether section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law is unconstitutional insofar as it purports to tax the accumulated income of a domestic international sales corporation (DISC), an entity which is the beneficiary of certain tax advantages under the Internal Revenue Code. A related issue concerns the obligation of a corporation doing business in New York, which is a shareholder of a DISC, when calculating its own income for state franchise tax purposes, to include income deemed to have been distributed to it by the DISC. The facts have been stipulated.

Petitioner, Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation, does business in New York. It owns all of the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation,

which acted as a commission agent for Westinghouse and affiliated companies, and which in 1972 and 1973 had qualified for DISC status under the Internal Revenue Code (U.S. Code tit. 26 § 991 *et seq.*). Westinghouse DISC's business income consisted entirely of commissions derived from export sales of products and related services made on behalf of Westinghouse and affiliated companies. Throughout this period it did not engage in any business activities in New York.

Under the provisions of the Internal Revenue Code, Westinghouse DISC itself was exempt from Federal income tax liability. However, a portion of its earnings and profits was "deemed distributed" to its shareholder (Westinghouse), whether or not it was actually distributed, and was directly taxable to the latter as a dividend (U.S. Code, tit. 26, § 995, subd. [b]). Federal taxation of the remainder of Westinghouse DISC's income, characterized as "accumulated income", was deferred. When Westinghouse filed its New York corporation franchise tax returns for these years, it included the deemed distributions from Westinghouse DISC in its net income, but not any portion of the DISC's accumulated income.

The State Department of Taxation and Finance charged that deficiencies existed in the amount of franchise tax due from Westinghouse. Specifically, the department, relying on section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, maintained that in arriving at its franchise tax Westinghouse should have combined all of Westinghouse DISC's income and expenses with its own, other than transactions between the two companies. Except for correcting an arithmetic error, respondents rejected Westinghouse's petition challenging the deficiencies and this proceeding followed.

We determined that section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, to the extent it requires Westinghouse DISC's accumulated income be added to petitioner's income, is unconstitutional, for it settles an impermissible burden on foreign commerce (U.S. Const., art. I, § 8, cl. [3]).

Enacted in 1971, sections 991 through 997 of the Internal Revenue Code created DISCs, a new class of corporation.

These corporations, receiving special tax treatment, derive substantially all of their income from export sales of properties manufactured in the United States, including commissions attributable to such sales. The essential purpose behind enactment of the DISC provisions was to encourage exportation to foreign countries of American made products so as to alleviate a burgeoning deficit in the United States balance of payments (*Caterpillar Tractor Co. v. United States*, 589 F.2d 1040). A correlative concern, expressed by the Senate Finance Committee, was to remove a competitive disadvantage experienced by domestic corporations engaged in export activities (S. Rep. No. 92-437, 92nd Cong., 1st Sess. 90 [1971] reprinted in [1971] U.S. Code Cong. & Admin. News, pp. 1918, 1996). The DISC provisions of the Code being unmistakably aimed at improving foreign commerce, any state impediment hindering that congressional intent is not constitutionally allowable.

In the calculation of the New York State franchise tax, section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law directs that a DISC's shareholder's attributable share of each receipt and expense of the DISC be added to the shareholder's income. Since that requires Westinghouse DISC's accumulated income be added to Westinghouse's entire net income, to be taxed thereon, it in effect imposes a tax on Westinghouse DISC's accumulated income, contrary to the congressionally established policy that such income currently be treated as tax exempt. By so computing petitioner's franchise tax, respondents encumber Congress's purpose in creating DISCs, for they diminish the tax advantage Congress bestowed on United States corporations engaged in foreign export trade. Although the Code's DISC provisions do not explicitly prohibit states from directly or indirectly taxing accumulated income, given their purpose it would be incongruous to suggest such a prohibition was not intended. As the State's statute infringes on Congress's power to regulate commerce, it necessarily must fall (*see Boston Stock Exchange v. State Tax Comm.*, 429 U.S. 318; *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414).

Petitioner also maintains that the inclusion of Westinghouse DISC's deemed distributions in Westinghouse's in-

come is invalid on equal protection and due process grounds. Neither claim is convincing.

With regard to its equal protection argument, Westinghouse urges that since dividends from subsidiaries, in general, are not subject to New York franchise tax, respondents have discriminated against it by requiring petitioner to include in its net income deemed distributions from Westinghouse DISC. There is nothing in the record to indicate that petitioner's tax liability resulting from a combined report, which in view of the extensive intercompany transactions could have been required here if Westinghouse DISC had been considered merely as a subsidiary (Tax Law, § 211, subd. 4; *Matter of Wurlitzer Co. v. State Tax Comm.*, 35 N.Y.2d 100), would be less than that which was in fact imposed.

As for the due process argument, Westinghouse maintains Westinghouse DISC neither engaged in business in New York nor participated in any other activities sufficient to justify a jurisdictional nexus and that, therefore, inclusion of the DISC's deemed distributions was improper. But where, as here, the activities of the parent and subsidiary are so interrelated as to constitute a single unitary business, separate geographical accounting is not required for purposes of state taxation and a reasonable apportionment formula fairly representing the amount of business apportioned to the state may be utilized (*Mobil Oil Corp. v. Comr. of Taxes*, 445 U.S. 425).

Determination annulled, with costs, and matter remitted to the State Tax Commission for further proceedings not inconsistent herewith.

MAIN, MIKOLL and YESAWICH, JR., JJ., concur; MAHONEY, P. J., and HERLIHY, J., dissent and vote to confirm in the following memorandum by HERLIHY, J. HERLIHY, J. (dissenting).

We join in the majority opinion as to the conclusion that the tax at issue herein does not violate the requirements of due process or equal protection.

However, while petitioner's view of the Federal treatment of income derived from domestic corporations engaged in export activities as regulating foreign commerce has some merit, the fact remains that the Internal Revenue Code does not exempt the income from taxation. The tax imposed herein is based upon the taxpayer's relationship to the wholly-owned subsidiary and is unrelated to the subsidiary's function of overseas sales—foreign commerce.

Petitioner has failed to demonstrate any tax imposed on foreign commerce or any implicit prohibition on the power of the State to allocate net income to the shareholder as a portion of income subject to the New York State franchise tax. Upon the present record, the inference that the Internal Revenue Code is an exclusive regulation of foreign commerce is speculative and does not suffice to overcome the presumption of the constitutionality of the New York statute.

The determination of the Tax Commission should be confirmed, and the petition dismissed.

ORDER OF THE NEW YORK SUPREME COURT

AT a Special Term of the Supreme Court of the State of New York, held in and for the County of Albany, at the Courthouse, in the City of Albany, New York, on the 25th day of January, 1980.

PRESENT:

Hon. EDWARD S. CONWAY,
Justice.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules
—against—

JAMES H. TULLY, JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

ORDER
Index No. 11313-79

Upon reading and filing the notice of petition and petition of Westinghouse Electric Corporation, verified the 18th day of December, 1979, and the answer and return of the respondents, verified the 10th day of January, 1980, and it appearing that one of the issues involved is whether the determination of the respondents made as a result of a hearing and at which evidence was taken pursuant to direction by law is, on the entire record, supported by substantial evidence, and due deliberation having been had,

NOW, upon motion of Robert Abrams, Attorney General of the State of New York, attorney for respondents, it is

ORDERED, that pursuant to section 7804(g) of the Civil Practice Law and Rules, the above-entitled proceeding be and the same hereby is transferred to the Appellate Division of the Supreme Court, Third Judicial Department, for disposition.

Dated: Albany, New York
January 25, 1980

/s/ EDWARD S. CONWAY
J.S.C.

ENTER:

DECISION OF THE STATE TAX COMMISSION

STATE OF NEW YORK STATE TAX COMMISSION

In the Matter of the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION

for Redetermination of a Deficiency or for Refund of Franchise Tax on a Business Corporation under Article 9-A of the Tax Law for the Years 1972 and 1973.

DECISION

Petitioner, Westinghouse Electric Corporation, Gateway Center, Pittsburgh, Pennsylvania 15225, filed a petition for redetermination of a deficiency or for refund of franchise tax on a business corporation under Article 9-A of the Tax Law for the years 1972 and 1973 (File No. 17433).

A formal hearing was held before Julius E. Braun, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 18, 1978 at 1:15 P.M. Petitioner appeared by Cravath, Swaine and Moore, Esqs. (Henry W. DeKosmian, Esq. and Patricia Geoghegan, Esq., of counsel). The Corporation Tax Bureau appeared by Peter Crotty, Esq. (James Morris, Esq., of counsel).

ISSUE

Whether section 208.9(i)(B) of the Tax Law which required petitioner to consolidate the receipts, expenses, assets and liabilities of its wholly owned subsidiary, Westinghouse Electric Export Corporation (a "DISC" corporation), with its own, in computing its New York income tax liability, is constitutional.

FINDINGS OF FACT

1. On June 15, 1976 pursuant to a field audit, the Corporation Tax Bureau issued a Statement of Audit Adjustment to petitioner, Westinghouse Electric Corporation, for the periods ending December 31, 1972 and December 31, 1973, assessing additional tax. Accordingly, a Notice of Deficiency was issued on the same day for $73,970.23, plus interest of $18,026.55, for a total of $91,996.78, for the period ending December 31, 1972, and $151,436.76, plus interest of $25,547.38, for a total of $176,984.14 for the period ending December 31, 1973. Due to the transposition of numbers by the auditor, the tax due should be $71,970.00, plus interest, for the period ending December 31, 1972.

2. Petitioner, Westinghouse Electric Corporation, and the Corporation Tax Bureau stipulated and agreed as follows:

a. Petitioner, Westinghouse Electric Corporation ("Westinghouse"), is a Pennsylvania corporation which does business in New York State.

b. Westinghouse Electric Export Corporation ("DISC") is a Delaware corporation which elected to be treated as a domestic international sales organization for Federal income tax purposes and was so treated for the years 1972 and 1973.

c. Westinghouse owns all the stock of DISC.

d. Westinghouse and DISC keep their records on the accrual method of accounting.

e. During 1972 and 1973, DISC qualified under Section 992(a) of the Internal Revenue Code of 1954 (the "Code") and was exempt from Federal income tax for such years under Section 991 of the Code.

f. DISC was commission agent for Westinghouse and affiliated companies in respect of export sales of property and related services. All of DISC's business income for 1972 and 1973 consisted of commissions paid it in respect of

export sales of products and related services by Westinghouse and other affiliated companies.

g. DISC reported total income on Federal Form 1120-DISC for 1972 and 1973 in the amounts of $25,987,000 and $57,948,738, respectively. Of DISC's total 1972 income, $19,888,000 was received from Westinghouse and $6,099,000 was received from other affiliated companies not doing business in New York State.

h. DISC did not make any distributions to Westinghouse in 1972. DISC distributed $10,068,500 to Westinghouse in 1973, all of which was treated as made out of previously taxed income under Section 996(a)(1) of the Code.

i. $12,956,500 of DISC's total income for 1972 and $29,838,006 of its taxable income for 1973 was deemed distributed by DISC to Westinghouse in 1972 and 1973, respectively, under Section 995(b) of the Code and Westinghouse included those amounts in its Federal gross income for 1972 and 1973. Federal taxation of the remainder of DISC's total income for 1972 and 1973 (the "accumulated DISC income") was deferred under the DISC provisions of the Code.

j. During 1972 and 1973, DISC had no paid employees, did not engage in any business activities in New York, nor did it employ capital, own or lease real or tangible personal property, pay real estate rentals, or maintain an office in New York State at any time during such years.

k. DISC did not file a New York corporate franchise tax return for either 1972 or 1973 because it and Westinghouse take the position that DISC was not subject to New York jurisdiction.

l. Westinghouse filed Form CT-3 with the State of New York for 1972 and 1973 as a Pennsylvania corporation doing business in New York. Its reported entire net income for 1972 and 1973 was $136,516,711 and

$43,715,850, respectively, which included the $12,956,500 and $29,838,006 deemed distributions from DISC for those years but did not include any portion of DISC's accumulated DISC income for such years. The deemed distributions were allocated to New York according to Westinghouse's business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973, computed without regard to such deemed distributions.

m. In separate Notices of Deficiency dated June 15, 1976, the Corporation Tax Bureau of the Department of Taxation and Finance alleged deficiencies in Westinghouse's corporate franchise tax of $73,970.23 for 1972 and $151,436.76 for 1973.

n. The entire amount of the alleged deficiencies relates to Westinghouse's treatment of the total income of DISC for 1972 and 1973 on Westinghouse's own returns.

o. The alleged deficiencies were computed as follows:

(1) Because more than 5% of DISC's gross receipts in both 1972 and 1973 consisted of sales commissions from Westinghouse, DISC would have been exempt from New York franchise tax under Section 208.9(i)(A) of Chapter 60, Article 9-A of the New York Tax Law whether or not New York otherwise had jurisdiction to subject it to tax. It is therefore alleged in the Notices of Deficiency that Westinghouse is required under Section 208.9(i)(B) of the Tax Law to consolidate DISC's receipts, expenses, assets and liabilities with its own in computing its New York income tax liability, excluding all transactions between Westinghouse and DISC.

(2) Since Westinghouse only included the deemed distributions from DISC for 1972 and 1973, and not the DISC's accumulated DISC income for such years, in its own entire net income for 1972 and 1973, it is proposed in the Notices of Deficiency that

Westinghouse's entire net income for 1972 be increased by $13,390,500 from $136,516,711 to $149,907,211 and that its entire net income for 1973 be increased by $28,110,732 from $43,715,850 to $71,826,582. In addition, it is proposed in the Notices of Deficiency that the receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 be recomputed by adding DISC's commission income derived from customers other than Westinghouse (which other customers did not do business in New York and were not subject to New York tax) for such years to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return, to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two proposed adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New York from $8,683,334 to $9,533,778, an increase of $580,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the two proposed adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28.

(3) It is proposed in the Notice of Deficiency, however, that Westinghouse be allowed credits under Section 210(13)(a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500, and $28,110,732, representing the DISC's accumulated DISC income for 1972 and 1973

respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively, those being the percentages of Westinghouse's receipts from export property on which DISC earned a sales commission and which was shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973.

(4) The respective products, $638,901 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 alleged to be includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, was found to be eligible for credit under Section 210(13)(a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

p. Westinghouse paid franchise tax under Article 9-A of the Tax Law in the amounts of $749,384 and $205,548, respectively, for 1972 and 1973. The taxes so paid by Westinghouse reflected the inclusion in its business income for 1972 and 1973 of the deemed distributions in the amounts of $12,956,500 and $29,838,006 for 1972 and 1973, respectively.

q. With respect to Westinghouse's assignment of error number 2 of the Perfected Petition, the Department of Taxation and Finance for the State of New York concedes that the proposed increase in Westinghouse's entire net income for 1972 under the State's theory should be $13,030,500 rather than $13,390,500 and that therefore the proposed deficiency for 1972 is $71,970.

r. The parties agree to reserve the calculation of the amount of any deficiency or refund until ultimate resolution of the issues raised in Westinghouse's petition.

s. The petition in this action was timely filed on September 10, 1976.

CONCLUSIONS OF LAW

A. That the constitutionality of the laws of the State of New York is presumed at the administrative level. Accordingly, the State Tax Commission does not have jurisdiction to declare such laws unconstitutional and it must be presumed that section 208.9(i)(B) of the Tax Law is constitutional to the extent that it relates to the imposition of the tax which is the subject of this proceeding.

B. That the petition of Westinghouse Electric Corporation is denied and the notices of deficiency issued June 15, 1976, are sustained.

DATED: Albany, New York
August 31, 1979

STATE TAX COMMISSION

/s/ JAMES H. TULLY, JR.
President

/s/ MILTON KOERNER
Commissioner

/s/ THOMAS H. LYNCH
Commissioner

ORDER OF THE COURT OF APPEALS

COURT OF APPEALS
STATE OF NEW YORK
The Hon. Lawrence H. Cooke, Chief Judge, Presiding

3	No. 97
In the Matter of WESTINGHOUSE ELECTRIC CORPORATION, *Respondent-Appellant,*	
v.	
JAMES H. TULLY, JR., & ors., as the Tax Commission of the State of New York, *Appellants-Respondents.*	

The appellant(s)-respondents in the above entitled appeal appeared by Robert Abrams, Attorney General;

The respondent(s)-appellant appeared by Cravath, Swaine & Moore.

The Court, after due deliberation, orders and adjudges that the judgment is modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed. Opinion by Judge Fuchsberg. Chief Judge Cooke and Judges Jasen, Gabrielli, Jones, Wachtler and Meyer concur.

The Court further orders that the papers required to be filed and this record of the proceedings in this Court be remitted to the Supreme Court, Albany County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

JOSEPH W. BELLACOSA

Joseph W. Bellacosa,
Clerk of the Court

Court of Appeals, Clerk's Office, Albany, April 1, 1982.

NOTICE OF APPEAL

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF ALBANY

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

—against—

JAMES H. TULLY, JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

Index No. 11313/1979

Notice of Appeal to the Supreme Court of the United States

NOTICE is hereby given that Westinghouse Electric Corporation, the petitioner above-named, hereby appeals to the Supreme Court of the United States from each and every part of the final decision of the Court of Appeals of the State of New York filed April 1, 1982, modifying the judgment of the Appellate Division of the Supreme Court of the State of New York entered on June 29, 1981, by reinstating the determination of respondents.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

June 28, 1982.

CRAVATH, SWAINE & MOORE,
Attorneys for Petitioner,
One Chase Manhattan Plaza,
New York, N. Y. 10005
(212) 422-3000

To:

HON. ROBERT ABRAMS,
Attorney General of
the State of New York,
Attorney for Respondents,
The Capitol,
Albany, New York 12224

CLERK,
Supreme Court, Albany County,
Court House,
Albany, New York 12207.

Office of
Albany County Clerk
Albany, N.Y.
Jun. 28,
12:39 p.m. '82

CLERK,
Court of Appeals,
State of New York,
20 Eagle St.,
Albany, New York 12207.

RECEIVED
Jun. 28, 1982
COURT OF APPEALS

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

Article I, Section 8

The Congress shall have Power . . .

[3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes.

Article VI

[2] This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Amendment 14, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the States wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

INTERNAL REVENUE CODE OF 1954, AS AMENDED
(as in effect in 1972 and 1973)

PART IV—DOMESTIC INTERNATIONAL SALES CORPORATION

A. Treatment of qualifying corporations.

B. Treatment of distributions to shareholders.

SUBPART A—TREATMENT OF QUALIFYING CORPORATIONS

§ 991. Taxation of a domestic international sales corporation.

§ 992. Requirements of a domestic international sales corporation.

§ 993. Definitions and special rules.

§ 994. Inter-company pricing rules.

§ 991. ***Taxation of a Domestic International Sales Corporation***

For purposes of the taxes imposed by this subtitle upon a DISC (as defined in section 992(a)), a DISC shall not be subject to the taxes imposed by this subtitle except for the tax imposed by chapter 5.

§ 992. ***Requirements of a Domestic International Sales Corporation***

(a) **Definition of "DISC" and "former DISC".**

(1) **DISC.**—For purposes of this title, the term "DISC" means, with respect to any taxable year, a corporation which is incorporated under the laws of any State and satisfies the following conditions for the taxable year:

(A) 95 percent or more of the gross receipts (as defined in section 993(f)) of such corporation consist of qualified export receipts (as defined in section 993(a)),

(B) the adjusted basis of the qualified export assets (as defined in section 993(b)) of the corpo-

ration at the close of the taxable year equals or exceeds 95 percent of the sum of the adjusted basis of all assets of the corporation at the close of the taxable year,

(C) such corporation does not have more than one class of stock and the par or stated value of its outstanding stock is at least $2,500 on each day of the taxable year; and

(D) the corporation has made an election pursuant to subsection (b) to be treated as a DISC and such election is in effect for the taxable year.

(2) **Status as DISC after having filed a return as a DISC.**—The Secretary or his delegate shall prescribe regulations setting forth the conditions under and the extent to which a corporation which has filed a return as a DISC for a taxable year shall be treated as a DISC for such taxable year for all purposes of this title, notwithstanding the fact that the corporation has failed to satisfy the conditions of paragraph (1).

(3) **"Former DISC".**—For purposes of this title, the term "former DISC" means, with respect to any taxable year, a corporation which is not a DISC for such year but was a DISC in a preceding taxable year and at the beginning of the taxable year has undistributed previously taxed income or accumulated DISC income.

(b) Election.

(1) Election.

(A) An election by a corporation to be treated as a DISC shall be made by such corporation for a taxable year at any time during the 90-day period immediately preceding the beginning of the taxable year, except that the Secretary or his delegate may give his consent to the making of an election at such other times as he may designate.

(B) Such election shall be made in such manner as the Secretary or his delegate shall prescribe and shall be valid only if all persons who are shareholders in such corporation on the first day of the first taxable year for which such election is effective consent to such election.

(2) Effect of election.—If a corporation makes an election under paragraph (1), then the provisions of this part shall apply to such corporation for the taxable year of the corporation for which made and for all succeeding taxable years and shall apply to each person who at any time is a shareholder of such corporation for all periods on or after the first day of the first taxable year of the corporation for which the election is effective.

(3) Termination of election.

(A) Revocation.—An election under this subsection made by any corporation may be terminated by revocation of such election for any taxable year of the corporation after the first taxable year of the corporation for which the election is effective. A termination under this paragraph shall be effective with respect to such election

(i) for the taxable year in which made, if made at any time during the first 90 days of such taxable year, or

(ii) for the taxable year following the taxable year in which made, if made after the close of such 90 days,

and for all succeeding taxable years of the corporation. Such termination shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(B) Continued failure to be DISC.—If a corporation is not a DISC for each of any 5 consecutive

taxable years of the corporation for which an election under this subsection is effective, the election shall be terminated and not be in effect for any taxable year of the corporation after such 5th year.

(c) Distributions to meet qualification requirements.

(1) In general. Subject to the conditions provided by paragraph (2), a corporation which for a taxable year does not satisfy a condition specified in paragraph (1)(A) (relating to gross receipts) or (1)(B) (relating to assets) of subsection (a) shall nevertheless be deemed to satisfy such condition for such year if it makes a pro rata distribution of property after the close of the taxable year to its shareholders (designated at the time of such distribution as a distribution to meet qualification requirements) with respect to their stock in an amount which is equal to

(A) if the condition of subsection (a)(1)(A) is not satisfied, the portion of such corporation's taxable income attributable to its gross receipts which are not qualified export receipts for such year,

(B) if the condition of subsection (a)(1)(B) is not satisfied, the fair market value of those assets which are not qualified export assets on the last day of such taxable year, or

(C) if neither of such conditions is satisfied, the sum of the amounts required by subparagraphs (A) and (B).

(2) Reasonable cause for failure.—The conditions under paragraph (1) shall be deemed satisfied in the case of a distribution made under such paragraph

(A) if the failure to meet the requirements of subsection (a)(1)(A) or (B), and the failure to make such distribution prior to the date on which made, are due to reasonable cause; and

(B) the corporation pays, within the 30-day period beginning with the day on which such distribution is made, to the Secretary or his delegate, if such corporation makes such distribution after the 15th day of the 9th month after the close of the taxable year, an amount determined by multiplying (i) the amount equal to 4½ percent of such distribution, by (ii) the number of its taxable years which begin after the taxable year with respect to which such distribution is made and before such distribution is made. For purposes of this title, any payment made pursuant to this paragraph shall be treated as interest.

(3) Certain distributions made within 8½ months after close of taxable year deemed for reasonable cause.—A distribution made on or before the 15th day of the 9th month after the close of the taxable year shall be deemed for reasonable cause for purposes of paragraph (2)(A) if—

(A) at least 70 percent of the gross receipts of such corporation for such taxable year consist of qualified export receipts, and

(B) the adjusted basis of the qualified export assets held by the corporation on the last day of each month of the taxable year equals or exceeds 70 percent of the sum of the adjusted basis of all assets held by the corporation on such day.

(d) **Ineligible corporations.**—The following corporations shall not be eligible to be treated as a DISC—

(1) a corporation exempt from tax by reason of section 501,

(2) a personal holding company (as defined in section 542),

(3) a financial institution to which section 581 or 593 applies,

(4) an insurance company subject to the tax imposed by subchapter L,

(5) a regulated investment company (as defined in section 851(a)

(6) a China Trade Act corporation receiving the special deduction provided in section 941(a), or

(7) an electing small business corporation (as defined in section 1371(b).

(e) Coordination with personal holding company provisions in case of certain produced film rents—If—

(1) a corporation (hereinafter in this subsection referred to as "subsidiary") was established to take advantage of the provisions of this part, and

(2) a second corporation (hereinafter in this subsection referred to as "parent") throughout the taxable year owns directly at least 80 percent of the stock of the subsidiary;

then, for purposes of applying subsection (d)(2) and section 541 (relating to personal holding company tax) to the subsidiary for the taxable year, there shall be taken into account under section 543(a)(5) (relating to produced film rents) any interest in a film acquired by the parent and transferred to the subsidiary as if such interest were acquired by the subsidiary at the time it was acquired by the parent.

§ 993. ***Definitions***

(a) **Qualified export receipts—**

(1) **General rule.**—For purposes of this part, except as provided by regulations under paragraph (2), the qualified export receipts of a corporation are—

(A) gross receipts from the sale, exchange, or other disposition of esport property,

(B) gross receipts from the lease or rental of export property, which is used by the lessee of such property outside the United States,

(C) gross receipts for services which are related and subsidiary to any qualified sale, exchange, lease, rental, or other disposition of export property by such corporation,

(D) gross receipts from the sale, exchange, or other disposition of qualified export assets (other than export property),

(E) dividends (or amounts includible in gross income under section 951) with respect to stock of a related foreign export corporation (as defined in subsection (e)

(F) interest on any obligation which is a qu.. .- fied export asset,

(G) gross receipts for engineering or architectural services for construction projects located (or proposed for location) outside the United States, and

(H) gross receipts for the performance or managerial services in furtherance of the production of other qualified export receipts of a DISC.

(2) **Excluded receipts.**—The Secretary or his delegate may under regulations designate receipts from the sale, exchange, lease, rental, or other disposition of export property, and from services, as not being receipts described in paragraph (1) if he determines that such sale, exchange, lease, rental, or other disposition, or furnishing of services—

(A) is for ultimate use in the United States;

(B) is accomplished by a subsidy granted by the United States or any instrumentality thereof;

(C) is for use by the United States or any instrumentality thereof where the use of such export property or services is required by law or regulation.

For purposes of this part, the term "qualified export receipts" does not include receipts from a corporation which is a DISC for its taxable year in which the receipts arise and which is a member of a controlled group (as defined in paragraph (3) which includes the recipient corporation.

(3) **Definition of controlled group.**—For purposes of this part, the term "controlled group" has the meaning assigned to such term by section 1563(a), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears therein, and section 1563(b) shall not apply.

(b) **Qualified export assets.**—For purposes of this part, the qualified export assets of a corporation are—

(1) export property (as defined in subsection (c);

(2) assets used primarily in connection with the sale, lease, rental, storage, handling, transportation, packaging, assembly, or servicing of export property, or the performance of engineering or architectural services described in subparagraph (G) of subsection (a)(1) or managerial services in furtherance of the production of qualified export receipts described in subparagraphs (A), (B), (C), and (G) of subsection (a)(1);

(3) accounts receivable and evidences of indebtedness which arise by reason of transactions of such corporation described in subparagraphs (A), (B), (C), (G), or (H), of subsection (a)(1);

(4) money, bank deposits, and other similar temporary investments, which are reasonably necessary to meet the working capital requirements of such corporation;

(5) obligations arising in connection with a producer's loan (as defined in subsection (d);

(6) stock or securities of a related foreign export corporation (as defined in subsection (e);

(7) obligations issued, guaranteed, or insured, in whole or in part, by the Export-Import Bank of the United States or the Foreign Credit Insurance Association in those cases where such obligations are required from such Bank or Association or from the seller or purchaser of the goods or services with respect to which such obligations arose;

(8) obligations issued by a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the United States under which such corporation makes export loans guaranteed by such bank; and

(9) amounts (other than reasonable working capital) on deposit in the United States that are utilized during the period provided for in, and otherwise in accordance with, regulations prescribed by the Secretary or his delegate to acquire other qualified export assets.

(c) **Export property**—

(1) **In general.**—For purposes of this part, the term "export property" means property

(A) manufactured, produced, grown, or extracted in the United States by a person other than a DISC.

(B) held primarily for sale, lease, or rental, in the ordinary course of trade or business by, or to, a DISC, for direct use, consumption, or disposition outside the United States, and

(C) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.

In applying subparagraph (C), the fair market value of any article imported into the United States shall be its

appraised value, as determined by the Secretary or his delegate under section 402 or 402a of the Tariff Act of 1930 (19 U.S.C., Sec. 1401a or 1402) in connection with its importation.

(2) **Excluded property.**—For purposes of this part, the term "export property" does not include—

(A) property leased or rented by a DISC for use by any member of a controlled group (as defined in subsection (a)(3) which includes the DISC, or

(B) patents, inventions, models, designs, formulas, or processes, whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, for commercial or home use), good will, trademarks, trade brands, franchises, or other like property.

(3) **Property in short supply.**—If the President determines that the supply of any property described in paragraph (1) is insufficient to meet the requirements of the domestic economy, he may by Executive order designate the property as in short supply. Any property so designated shall be treated as property not described in paragraph (1) during the period beginning with the date specified in the Executive order and ending with the date specified in an Executive order setting forth the President's determination that the property is no longer in short supply.

(d) **Producer's loans.**—

(1) **In general.**—An obligation, subject to the rules provided in paragraphs (2) and (3), shall be treated as arising out of a producer's loan if—

(A) the loan, when added to the unpaid balance of all other producer's loans made by the DISC, does not exceed the accumulated DISC income at the beginning of the month in which the loan is made;

(B) the obligation is evidenced by a note (or other evidence of indebtedness) with a stated maturity date not more than 5 years from the date of the loan;

(C) the loan is made to a person engaged in the United States in the manufacturing, production, growing, or extraction of export property (referred to hereinafter as the "borrower"); and

(D) at the time of such loan it is designated as a producer's loan.

(2) **Limitation.**—An obligation shall be treated as arising out of a producer's loan only to the extent that such loan, when added to the unpaid balance of all other producer's loans to the borrower outstanding at the time such loan is made, does not exceed an amount determined by multiplying the sum of—

(A) the amount of the borrower's adjusted basis determined at the beginning of the borrower's taxable year in which the loan is made, in plant, machinery, and equipment, and supporting production facilities in the United States;

(B) the amount of the borrower's property held primarily for sale, lease, or rental, to customers in the ordinary course of trade or business, at the beginning of such taxable year; and

(C) the aggregate amount of the borrower's research and experimental expenditures (within the meaning of section 174) in the United States during all preceding taxable years beginning after December 31, 1971,

by the percentage which the borrower's receipts, during the 3 taxable years immediately preceding the taxable year (but not including any taxable year commencing prior to 1972) in which the loan is made, from the sale, lease, or rental outside the United States of property which would

be export property if held by a DISC is of the gross receipts during such 3 taxable years from the sale, lease, or rental of property held by such borrower primarily for sale, lease, or rental to customers in the ordinary course of the trade or business of such borrower.

(3) **Increased investment requirement.**—An obligation shall be treated as arising out of a producer's loan in a taxable year only to the extent that such loan, when added to the unpaid balance of all other producer's loans to the borrower made during such taxable year, does not exceed an amount equal to—

(A) the amount by which the sum of the adjusted basis of assets described in paragraph (2)(A) and (B) on the last day of the taxable year in which the loan is made exceeds the sum of the adjusted basis of such assets on the first day of such taxable year; plus

(B) the aggregate amount of the borrower's research and experimental expenditures (within the meaning of section 174) in the United States during such taxable year.

(4) **Special limitation in the case of domestic film maker.** . . .

(e) **Related foreign export corporation.**—In determining whether a corporation (hereinafter in this subsection referred to as "the domestic corporation") is a DISC—

(1) **Foreign international sales corporation.**—A foreign corporation is a related foreign export corporation if—

(A) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly by the domestic corporation,

(B) 95 percent or more of such foreign corporation's gross receipts for its taxable year ending with

or within the taxable year of the domestic corporation consists of qualified export receipts described in subparagraphs (A), (B), (C), and (D) of subsection (a)(1) and interest on any obligation described in paragraphs (3) and (4) of subsection (b), and

(C) the adjusted basis of the qualified export assets (described in paragraphs (1), (2), (3), and (4) of subsection (b)) held by such foreign corporation at the close of such taxable year equals or exceeds 95 percent of the sum of the adjusted basis of all assets held by it at the close of such taxable year.

(2) **Real property holding company.**—A foreign corporation is a related foreign export corporation if—

(A) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly by the domestic corporation, and

(B) its exclusive function is to hold real property for the exclusive use (under a lease or otherwise) of the domestic corporation.

(3) **Associated foreign corporation.**—A foreign corporation is a related foreign export corporation if—

(A) less than 10 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation is owned (within the meaning of section 1563(d) and (e)) by the domestic corporation or by a controlled group of corporations (within the meaning of section 1563) of which the domestic corporation is a member, and

(B) the ownership of stock or securities in such foreign corporation by the domestic corporation is determined (under regulations prescribed by the Secretary or his delegate) to be reasonably in furtherance

of a transaction or transactions giving rise to qualified export receipts of the domestic corporation.

(f) **Gross receipts.**—For purposes of this part, the term "gross receipts" means the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of trade or business, and gross income from all other sources. In the case of commissions on the sale, lease, or rental of property, the amount taken into account for purposes of this part as gross receipts shall be the gross receipts on the sale, lease, or rental of the property on which such commissions arose.

(g) **United States defined.**—For purposes of this part, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

§ 994. *Inter-Company Pricing Rules*

(a) **In general.**—In the case of a sale for export property to a DISC by a person described in Section 482, the taxable income of such DISC and such person shall be based upon a transfer price which would allow such DISC to derive taxable income attributable to such sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of—

(1) 4 percent of the qualified export receipts on the sale of such property by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts,

(2) 50 percent of the combined taxable income of such DISC and such person which is attributable to the qualified export receipts on such property derived as the result of a sale by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts, or

(3) taxable income based on the sale price actually charged (but subject to the rules provided in section 482).

(b) **Rules for commissions, rentals, and marginal costing.**—The Secretary or his delegate shall prescribe regulations setting forth—

(1) rules which are consistent with the rules set forth in subsection (a) for the application of this section in the case of commissions, rentals, and other income, and

(2) rules for the allocation of expenditures in computing combined taxable income under subsection (a)(2) in those cases where a DISC is seeking to establish or maintain a market for export property.

(c) **Export Promotion expenses.**—For purposes of this section, the term "export promotion expenses" means those expenses incurred to advance the distribution or sale of export property for use, consumption, or distribution outside of the United States, but does not include income taxes. Such expenses shall also include freight expenses to the extent of 50 percent of the cost of shipping export property aboard airplanes owned and operated by United States persons or ships documented under the laws of the United States in those cases where law or regulations does not require that such property be shipped aboard such airplanes or ships.

SUBPART B—TREATMENT OF DISTRIBUTIONS TO SHAREHOLDERS

§ 995. Taxation of DISC income to shareholders.

§ 996. Rules for allocation in the case of distributions and losses.

§ 997. Special subchapter C rules.

§ 995. ***Taxation of DISC Income to Shareholders.***

(a) **General rule.**—A shareholder of a DISC or former DISC shall be subject to taxation on the earnings and profits of a DISC as provided in this chapter, but subject to the modifications of this subpart.

(b) **Deemed distributions.**—

(1) **Distributions in qualified years.**—A shareholder of a DISC shall be treated as having received a distribution taxable as a dividend with respect to his stock in an amount which is equal to his pro rata share of the sum (or, if smaller, the earnings and profits for the taxable year) of—

(A) the gross interest derived during the taxable year from producer's loans,

(B) the gain recognized by the DISC during the taxable year on the sale or exchange of property, other than property which in the hands of the DISC is a qualified export asset, previously transferred to it in a transaction in which gain was not recognized in whole or in part, but onlv to the extent that the transferor's gain on the previous transfer was not recognized.

(C) the gain (other than the gain desribed in subparagraph (B)) recognized by the DISC during the taxable year on the sale or exchange of property (other than property which in the hands of the DISC is stock in trade or other property described in section 1221(1)) previously transferred to it in a transaction in which gain was not recognized in whole or in part but only to the extent that the transferor's gain on the previous transfer was not recognized and would have been treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 if the property had been sold or exchanged rather than transferred to the DISC.

(D) one-half of the excess of the taxable income of the DISC for the taxable year, before reduction for any distributions during the year, over the sum of the amounts deemed distributed for the taxable year under subparagraphs (A), (B), and (C), and.

(E) the amount of foreign investment attributable to producer's loans (as defined in subsection (d) of a DISC for the taxable year.

Distributions described in this paragraph shall be deemed to be received on the last day of the taxable year of the DISC in which the gross income (taxable income in the case of subparagraph (D)) was derived. In the case of a distribution described in subparagraph (E), earnings and profits for the taxable year shall include accumulated earnings and profits.

(2) **Distributions upon disqualification.**—

(A) A shareholder of a corporation which revoked its election to be treated as a DISC or failed to satisfy the conditions of section 992(a)(1) for a taxable year shall be deemed to have received (at the time specified in subparagraph (B)) a distribution taxable as a dividend equal to his pro rata share of the DISC income of such corporation accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC.

(B) Distributions described in subparagraph (A) shall be deemed to be received in equal installments on the last day of each of the 10 taxable years of the corporation following the year of the termination or disqualification described in subparagraph (A)(but in no case over more than the number of immediately preceding consecutive taxable years during which the corporation was a DISC).

(c) **Gain on disposition of stock in a DISC.**—If a shareholder disposes of stock in a DISC or former DISC, any gain recognized on such disposition shall be included in gross income as a dividend to the extent of the accumulated DISC income of such DISC or former DISC which is attributable to such stock and which was accumulated in taxable years of such corporation during the period or periods the stock disposed of

was held by such shareholder. If stock of the DISC or former DISC is disposed of in a transaction in which the separate corporation existence of the DISC or former DISC is terminated other than by a mere change in place of organization, however effected, any gain realized on the disposition of such stock in the transaction shall be recognized notwithstanding any other provision of this title to the extent of the accumulated DISC income of such DISC or former DISC which is attributable to such stock and which was accumulated in taxable years of such corporation during the period or periods the stock disposed of was held by the stockholder which disposed of such stock, and such gain shall be included in gross income as a dividend.

(d) **Foreign investment attributable to DISC earnings.**—For the purposes of this part

(1) **In general.**—The amount of foreign investment attributable to producer's loans of a DISC for a taxable year shall be the smallest of

(A) the net increase in foreign assets by members of the controlled group (as defined in section 993(a)(3)) which includes the DISC,

(B) the actual foreign investment by domestic members of such group, or

(C) the amount of outstanding producer's loans by such DISC to members of such controlled group.

(2) **Net increase in foreign assets.**—The term "net increase in foreign assets" of a controlled group means the excess of—

(A) the amount incurred by such group to acquire assets (described in section 1231(b)) located outside the United States over,

(B) the sum of

(i) the depreciation with respect to assets of such group located outside the United States;

(ii) the outstanding amount of stock or debt obligations of such group issued after December 31, 1971, to persons other than the United States persons or any member of such group;

(iii) one-half the earnings and profits of foreign members of such group and foreign branches of domestic members of such group;

(iv) one-half the royalties and fees paid by foreign members of such group to domestic members of such group; and

(v) the uncommitted transitional funds of the group as determined under paragraph (4).

For purposes of this paragraph, assets which are qualified export assets of a DISC (or would be qualified export assets if owned by a DISC) shall not be taken into account. Amounts described in this paragraph (other than in subparagraphs (B)(ii) and (v)) shall be taken into account only to the extent they are attributable to taxable years beginning after December 31, 1971.

(3) **Actual foreign investment.**—The term "actual foreign investment' by domestic members of a controlled group means the sum of—

(A) contributions to capital of foreign members of the group by domestic members of the group after December 31, 1971,

(B) the outstanding amount of stock or debt obligations of foreign members of such group (other than normal trade indebtedness) issued after December 31, 1971, to domestic members of such group,

(C) amounts transferred by domestic members of the group after December 31, 1971, to foreign branches of such members, and

(D) one-half the earnings and profits of foreign members of such group and foreign branches of

domestic members of such group for taxable years beginning after December 31, 1971.

As used in this subsection, the term "domestic member" means a domestic corporation which is a member of a controlled group (as defined in section 993(a)(3)), and the term "foreign member" means a foreign corporation which is a member of such a controlled group.

(4) **Uncommitted transitional funds.**—The uncommitted transitional funds of the group shall be an amount equal to the sum of—

(A) the excess of

(i) the amount of stock or debt obligations of domestic members of such group outstanding on December 31, 1971, and issued on or after January 1, 1968, to persons other than United States persons or any member of such group, but only to the extent the taxpayer establishes that such amount constitutes a long-term borrowing for purposes of the foreign direct investment program, over

(ii) the net amount of actual foreign investment by domestic members of such group during the period that such stock or debt obligations have been outstanding; and

(B) the amount of liquid assets to the extent not included in subparagraph (A) held by foreign members of such group and foreign branches of domestic members of such group on October 31, 1971, in excess of their reasonable working capital needs on such date.

For purposes of this paragraph, the term "liquid assets" means money, bank deposits (not including time deposits), and indebtedness of 2 years or less to maturity on the date of acquisition; and the actual foreign investment shall be determined under paragraph (3) without regard to the

date in subparagraph (A) of such paragraph and without regard to subparagraph (D) of such paragraph.

(5) **Special rule.**—Under regulations prescribed by the Secretary or his delegate the determinations under this subsection shall be made on a cumulative basis with proper adjustments for amounts previously taken into account.

§ 996. ***Rules for Allocation in the Case of Distributions and Losses***

(a) **Rules for actual distributions and certain deemed distributions—**

(1) **In general.**—Any actual distribution (other than a distribution described in paragraph (2) or to which section 995(c) applies) to a shareholder by a DISC (or former DISC) which is made out of earnings and profits shall be treated as made—

(A) first, out of previously taxed income, to the extent thereof,

(B) second, out of accumulated DISC income, to the extent thereof, and

(C) finally, out of other earnings and profits.

(2) **Qualifying distributions.**—Any actual distribution made pursuant to section 992(c) (relating to distributions to meet qualification requirements), and any deemed distribution pursuant to section 995(b)(1)(E) (relating to foreign investment attributable to producer's loans), shall be treated as made

(A) first, out of accumulated DISC income, to the extent thereof,

(B) second, out of the earnings and profits described in paragraph (1)(C), to the extent thereof, and

(C) finally, out of previously taxed income.

(3) **Exclusion from gross income.**—Amounts distributed out of previously taxed income shall be excluded by the distributee from gross income except for gains described in subsection (c)(2), and shall reduce the amount of the previously taxed income.

(b) **Ordering rules for losses.**—If for any taxable year a DISC, or a former DISC, incurs a deficit in earnings and profits, such deficit shall be chargeable—

(1) first, to earnings and profits described in subsection (a)(1)(C), to the extent thereof.

(2) second, to accumulated DISC income, to the extent thereof, and

(3) finally, to previously taxed income, except that a deficit in earnings and profits shall not be applied against accumulated DISC income which has been determined is to be deemed distributed to the shareholders (pursuant to section 995(b)(2)(A)) as a result of a revocation of election or other disqualification.

(c) **Priority of distributions.**—Any actual distribution made during a taxable year shall be treated as being made subsequent to any deemed distribution made during such year. Any actual distribution made pursuant to section 992(c) (relating to distributions to meet qualification requirements) shall be treated as being made before any other actual distributions during the taxable year.

(d) **Subsequent effect of previous disposition of DISC stock—**

(1) **Shareholder previously taxed income adjustment.—If—**

(A) gain with respect to a share of stock of a DISC or former DISC is treated under section 995(c) as a dividend or as gain from the sale or exchange of property which is not a capital asset, and

(B) any person subsequently receives an actual distribution made out of accumulated DISC income, or a deemed distribution made pursuant to section 995(b)(2), with respect to such share,

such person shall treat such distribution in the same manner as a distribution from previously taxed income to the extent that (i) the gain referred to in subparagraph (A), exceeds (ii) any other amounts with respect to such share which were treated under this paragraph as made from previously taxed income. In applying this paragraph with respect to a share of stock in a DISC or former DISC, gain on the acquisition of such share by the DISC or former DISC or gain on a transaction prior to such acquisition shall not be considered gain referred to in subparagraph (A).

(2) **Corporate adjustment upon redemption.**—If section 995(c) applies to a redemption of stock in a DISC or former DISC, the accumulated DISC income shall be reduced by an amount equal to the gain described in section 995(c) with respect to such stock which is (or has been) treated as gain from the sale or exchange of property which is not a capital asset, except to the extent distributions with respect to such stock have been treated under paragraph (1).

(e) **Adjustment to basis.**—

(1) **Additions to basis.**—Amounts representing deemed distributions as provided in section 995(b) shall increase the basis of the stock with respect to which the distribution is made.

(2) **Reductions of basis.**—The portion of an actual distribution made out of previously taxed income shall reduce the basis of the stock with respect to which it is made, and to the extent that it exceeds the adjusted basis of such stock, shall be treated as gain from the sale or exchange of property. In the case of stock includible in the

gross estate of a decedent for which an election is made under section 2032 (relating to alternate valuation), this paragraph shall not apply to any distribution made after the date of the decedant's death and before the alternate valuation date provided by section 2032.

(f) **Definitions of division of earnings and profits.**—For purposes of this part:

(1) **DISC income.**—The earnings and profits derived by a corporation during a taxable year in which such corporation is a DISC, before reduction for any distributions during the year, but reduced by amounts deemed distributed under section 995(b)(1), shall constitute the DISC income for such year. The earnings and profits of a DISC for a taxable year include any amounts includible in such DISC's gross income pursuant to section 951(a) for such year. Accumulated DISC income shall be reduced by deemed distributions under section 995(b)(2).

(2) **Previously taxed income.**—Earnings and profits deemed distributed under section 995(b) for a taxable year shall constitute previously taxed income for such year.

(3) **Other earnings and profits.**—The earnings and profits for a taxable year which are described in neither paragraph (1) nor (2) shall constitute the other earnings and profits for such year.

(g) **Effectively connected income.**—In the case of a shareholder who is a nonresident alien individual or a foreign corporation, trust, or estate, gains referred to in section 995(c) and all distributions out of accumulated DISC income including deemed distributions shall be treated as gains and distributions which are effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States.

§ 997. ***Special Subchapter C Rules***

For purposes of applying the provisions of subchapter C of Chapter 1, any distribution in property to a corporation by a

DISC or former DISC which is made out of previously taxed income or accumulated DISC income shall—

(1) be treated as a distribution in the same amount as if such distribution of property were made to an individual, and

(2) have a basis, in the hands of the recipient corporation, equal to the amount determined under paragraph (1).

New York Tax Law, Article 9-A
(as in effect in 1972 and 1973)

New York Tax Law § 208. ***Definitions***

As used in this article: l. The term "corporation" includes a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument; a "DISC" and a "former DISC" mean any corporation which meets the requirements of subsection (a) of section nine hundred ninety-two of the internal revenue code of nineteen hundred fifty-four . . . .

New York Tax Law § 208.8-A

8-A. Provided, however, that with respect to a DISC or a former DISC, the following provisions shall apply:

(a) investments in the stocks, bonds or other securities of a DISC or any indebtedness from a DISC shall not be treated as either subsidiary capital or investment capital under subdivisions four or five of this section,

(b) any amounts deemed distributed from a DISC or a former DISC which are taxable as dividends pursuant to subsection (b) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four shall be treated as business income, except any such amounts from a former DISC attributable to amounts includible in a taxpayer's entire net income for a prior taxable year under subparagraph (B) of paragraph (i) of subdivision nine of this section shall be excluded from entire net income,

(c) any gain recognized for federal income tax purposes on the disposition of stock in a DISC, and any gain recognized on the disposition of stock in a former DISC, includible in gross income as a dividend pursuant to subsection (c) of section nine hundred ninety-five of the

internal revenue code of nineteen hundred fifty-four, shall be treated as business income, and

(d) except as provided in paragraph (i) of subdivision nine of this section, any actual distribution from a DISC or a former DISC shall be treated as business income except an actual distribution which for federal income tax purposes is treated as made out of "other earnings and profits" under section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four, in which case such actual distribution shall be treated as either subsidiary income or investment income under this article.

New York Tax Law § 208.9(a)(1)

9. The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, or which the taxpayer would have been required to report, if it had not made an election under subchapter s of chapter one of the internal revenue code, except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section two hundred ten of this article.

(a) Entire net income shall not include:

(1) income, gains and losses from subsidiary capital which do not include the amount of a recovery in respect of any war loss except for such amounts from a former DISC which are treated as business income under subdivision eight-A of this section . . . .

New York Tax Law § 208.9(i)

(i) With respect to a DISC which during any taxable year or reporting year (1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders, (2) received more than five percent of its gross rentals from the rental of property which it purchased or rented from its stockholders or (3) received more

than five percent of its total receipts other than sales and rentals from its stockholders, the following provisions shall apply.

(A) For any taxable year in which subparagraph (B) of this paragraph is in effect and not rendered invalid, a DISC meeting the above test shall be exempt from all taxes imposed by this article.

(B) Supplemental to the provisions of subdivision five of section two hundred eleven of this article, any taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC meeting the test prescribed in this paragraph, shall for any taxable year ending after December thirty-first, nineteen hundred seventy-one adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities as reportable by each such DISC to the United States Treasury Department for its annual reporting period ending during the current taxable year of such taxpayer; provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department; and (3) that in the event this paragraph should be rendered invalid, all DISC's and their stockholders taxable hereunder shall be taxed instead under the remaining portions of this article.

New York Tax Law § 209.6

6. For any taxable year of a DISC, not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article, the taxes imposed by subdivision one of this

section shall be computed only under either clause two or clause four of paragraph (a) of subdivision one of section two hundred ten of this chapter, whichever is greater, and paragraph (b) of such subdivision.

New York Tax Law §§ 210.1-201.3

§ 210. *Computation of Tax*

1. The tax imposed by subdivision one of section two hundred nine of this chapter shall be, in the case of each taxpayer:

(a) a tax (1) computed at the rate of ten per centum on its entire net income, or the portion thereof allocated within the state as hereinafter provided, subject to any modification required by paragraphs (d) and (e) of subdivision three of this section, or (2) computed at one and seventy-eight hundredths mills for each dollar of its total business and investment capital, or the portion thereof allocated within the state as hereinafter provided, except that in the case of a cooperative housing corporation as defined in the internal revenue code, the applicable rate shall be four-tenths of a mill, or (3) computed at the rate of ten per centum on thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock minus fifteen thousand dollars (except as hereinafter provided) and any net loss for the reported year, or on the portion of such sum allocated within the state as hereinafter provided for the allocation of entire net income, subject to any modification required by paragraphs (d) and (e) of subdivision three of this section, or (4) two hundred fifty dollars, whichever is greatest, plus

(b) a tax computed at the rate of nine-tenths of a mill for each dollar of the portion of its subsidiary capital allocated within the state as hereinafter provided.

(c) In the case of a taxpayer which is not subject to tax for an entire year the exemption allowed in clause three

of paragraph (a) of this subdivision shall be prorated according to the period such taxpayer was subject to tax.

(d) If the taxable period for which the tax is due is less than an entire year, the minimum tax fixed by clause four of paragraph (a) of this subdivision shall be reduced by twenty-five percentum if the period for which such taxpayer is subject to tax is more than six months but not more than nine months and by fifty percentum if the period for which such taxpayer is subject to tax is not more than six months.

1-a. Notwithstanding any other provision of this chapter, for taxable years beginning before January first, nineteen hundred seventy-eight, an additional tax computed at the rate of five and three-quarters per centum on business income, or the portion thereof allocated within the state as hereinafter provided, is hereby imposed on every corporation subject to the tax imposed by this article which has gross receipts of five hundred thousand dollars or more for the taxable year from transportation, within this state, by omnibuses having a seating capacity of more than seven persons, other than receipts for the operation of school buses which are excluded from entire net income.

1-b. The computation specified in clause three of paragraph (a) of subdivision one shall not apply to a corporation organized under article fifteen of the business corporation law.

2. The amount of subsidiary capital, investment capital and business capital shall each be determined by taking the average fair market value of the gross assets included therein (less, in the case of business capital, average liabilities deductible therefrom which are payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, and, if the period covered by the report is other than a period of twelve calendar months, by multiplying such value by the number of calendar months or major parts thereof included in such period, and dividing the product thus obtained by twelve.

3. The portion of the entire net income of a taxpayer to be allocated within the state shall be deterined as follows:

(a) multiply its business income by a business allocation percentage to be determined by

(1) ascertaining the percentage which the average value of the taxpayer's real and tang ble personal property within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period;

(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

(A) sales of its tangible personal property where shipments are made to points within this state,

(B) services performed within the state,

(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and receipts from the sales of rights for closed-circuit and cable television transmissions of an event (other than events occurring on a regularly scheduled basis) taking place within the state as a result of the rendition of services by employees of the corporation, as athletes, entertainers or performing artists, but only to the extent that such receipts are attributable to such transmissions received or exhibited within the state and

(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties, receipts from the sales of rights for closed-circuit and cable television trans-

missions and all other business transactions, whether within or without the state;

(3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers; and

(4) adding together the percentages so determined and dividing the result by the number of percentages; provided, however, for taxable years beginning on or after the first day of January, nineteen hundred seventy-six, the business allocation percentage shall be determined by adding the percentages so determined and an additional percentage equal to the percentage determined under subparagraph two of this paragraph together, and dividing the result by the number of percentages so added together; provided, however, that for taxable years beginning before January first, nineteen hundred seventy-eight, if the taxpayer does not have a regular place of business outside the state other than a statutory office, the business allocation percentage shall be one hundred percent;

Provided, however, that any taxpayer required to adjust its receipts, expenses, assets and liabilities by adding an attributable portion of the receipts, expenses, assets and liabilities of any DISC, as provided by paragraph (i) of subdivision nine of section two hundred eight of this article, shall substitute such adjusted figures in computing the percentages required in subparagraphs one, two and three of this paragraph.

(b) multiplying its investment income by an investment allocation percentage to be determined by

(1) multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its

report by the percentage, if any, of the entire capital or the issued capital stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the state on the report or reports, if any, required of any such issuer or obligor under this chapter or the insurance law for the preceding year, but without regard to any minimum,

(2) adding together the sums so obtained,

(3) dividing the result so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities (other than obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities); provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the report, only such portion of such capital shall be taken into account; and provided further, that if a taxpayer's investment allocation percentage is zero, interest received on bank accounts, on obligations of the United States and its instrumentalities and on obligations of the state of New York, its political subdivisions and its instrumentalities shall be multiplied by its business allocation percentage; provided, however, that with respect to corporations organized under article fifteen of the business corporation law, the investment allocation percentage shall be one hundred percent; and

(c) add the products so obtained.

New York Tax Law § 210.13

13. (a) So long as the taxation procedures relating to a DISC provided in subparagraph (B) of paragraph (i) of subdivision nine of section two hundred eight of this article are in effect and not rendered invalid any taxpayer which during the taxable year being reported was a stockholder in any such DISC shall be allowed a DISC export credit, to be computed as hereinafter provided, against the tax imposed by this article

after allowance of any credit permitted under subdivision eleven and subdivision twelve of this section. The amount of the credit shall be computed separately for each such DISC, based upon its operations during its annual reporting period ending during the current taxable year of such stockholder, as follows:

(1) ascertaining the amount, if any, of such taxpayer's attributable share of the total current earnings and profits earned by such DISC for the reporting year which were included in its accumulated DISC income account pursuant to subsection (a) of section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four,

(2) ascertaining a percentage by (i) totaling the gross receipts from the sale, lease, rental or other disposition of export property (as defined under subsection (c) of section nine hundred ninety-three of the internal revenue code of nineteen hundred fifty-four) of the taxpayer by or to such DISC, and (ii) totaling such gross receipts from such export property of the taxpayer shipped from a regular place of business of the taxpayer within this state by or to such DISC and then (iii) dividing the total developed in (ii) above by that developed in (i) above (provided, however, for the purposes of this subparagraph, the tax commission may require such gross receipts to be computed on a similar basis for all such export property to properly reflect the percentage of such gross receipts attributable to export property shipped from a regular place of business of the taxpayer within this state),

(3) multiplying the amount ascertained in subparagraph one of this paragraph by the percentage ascertained in subparagraph two of this paragraph,

(4) ascertaining the amount of the taxpayer's taxable income as determined in subparagraphs one, two and three of this paragraph that is eligible for credit by multiplying the product ascertained in the preceding subparagraph by

the taxpayer's business allocation percentage determined as provided in paragraph (a) of subdivision three of this section,

(5) the amount of DISC export credit attributable to the operations of each such DISC is then found by multiplying seventy percent of the taxpayer's taxable income that is eligible for credit, as computed in the preceding subparagraph, by the rate of tax applying to the taxpayer, as provided in subdivision one of this section,

(6) the taxpayer's total DISC export credit is the sum of the DISC export credits attributable to each DISC that qualifies for tax exemption under paragraph (i) of subdivision nine of section two hundred eight of this article, in which it was a stockholder during the taxable year being reported.

(b) The credit allowed under this subdivision for any taxable year shall not reduce the tax due for such year to less than the minimum fixed by clause four of paragraph (a) of subdivision one of this section; nor may any unused credit be carried over to any following year.

New York Tax Law § 211. ***Reports***

1. Every taxpayer, as well as every foreign corporation having an employee, including any officer, within the state, shall annually on or before March fifteenth transmit to the tax commission a report in a form prescribed by it (except that a corporation which reports on the basis of a fiscal year shall transmit its report within two and one-half months after the close of its fiscal year and except, also, that a corporation which is a DISC shall transmit its report on or before the fifteenth day of the ninth month following the close of its calendar or fiscal year), setting forth such information as the tax commission may prescribe and every taxpayer which ceases to exercise its franchise or to be subject to the tax imposed by this article shall transmit to the tax commission a report on the date of such cessation or at such other time as the tax commission may

require covering each year or period for which no report was theretofore filed. Every taxpayer shall also transmit such other reports and such facts and information as the tax commission may require in the administration of this article. The tax commission may grant a reasonable extension of time for filing reports whenever good cause exists.

An automatic extension of three months for the filing of its annual report shall be allowed any taxpayer if, within the time prescribed by the preceding paragraph, such taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing the amount properly estimated as its tax.

New York Tax Law § 211.4

4. In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more corporations, or substanially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or by interests which own or control either directly or indirectly substantially all the capital stock of one or more other corporations, may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; provided, however, that any corporation which owns or controls either directly or indirectly substantially all the capital stock of a DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article shall be allowed, at the election of such corporation, to make a report on a combined basis covering such DISC, but the failure of such corporation to make such election shall not prohibit the tax commission from requiring a combined report covering such corporation and such DISC; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, becaue of intercompany transactions or some agreement,

understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article. In the case of a combined report the tax shall be measured by the combined entire net income or combined capital, of all the cororations included in the report. In computing combined entire net income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated, provided, however, that intercorporate dividends from a DISC or a former DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article which are taxable as business income under this article shall not be eliminated.